(1) 931993 JUN - 6 1994

No. ——— OFFICE OF THE CLERK

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1993

IN RE WELLS FARGO SECURITIES LITIGATION

WELLS FARGO & CO., *et al.*,
Petitioners,

v.

HOWARD GREENWALD, *et al.*,
Respondents.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

MELVIN R. GOLDMAN*
JACK W. LONDEN
PAUL FLUM
CAROLYN A. JOHNSTON
MORRISON & FOERSTER
345 California Street
San Francisco, CA 94104
(415) 677-7000

Attorneys for Petitioners

**Counsel of Record*

27 pp

QUESTIONS PRESENTED

1. Did the Ninth Circuit err in concluding, contrary to well-reasoned decisions from other circuits, that a complaint:

a. satisfies the misrepresentation element of a Rule 10b-5 claim by alleging that a bank's extraordinary increase in its loan loss reserve for one period implied that the reserve for a previous period was fraudulently understated?

b. satisfies the scienter element of a Rule 10b-5 claim by alleging that corporate defendants were motivated to perpetrate a fraud solely to maximize their compensation and job security?

2. Does this Court's decision in *Virginia Bankshares, Inc. v. Sandberg* establish a more lenient pleading standard for alleging fraud based on statements of opinion as opposed to fact?

PARTIES TO THE PROCEEDINGS

The parties to the proceedings below were defendants/petitioners: Wells Fargo & Co., Carl E. Reichardt, Paul Hazen, Robert L. Joss, Clyde W. Ostler, David M. Petrone, William F. Zuendt, Stephen A. Enna, Rodney L. Jacobs, Patrick W. Leahy, and Guy Rounsaville, Jr.; and plaintiffs/respondents: Howard Greenwald, Milton Friedman, Sheldon Shore, John Paul Decker, Fairmount Financial Corporation, Arthur-Magna, Inc., Harold Bloch, and Robert C. Schilling. Although the complaint alleges that this case has been brought as a class action, no certification of a class has yet been made.

Pursuant to Supreme Court Rule 29.1, Wells Fargo & Co. states that it has no parent companies. Wells Fargo & Co.'s non-wholly owned subsidiaries or affiliates are Wells Fargo Nikko Investment Advisors International, Wells Fargo Nikko Investment Advisors, Wells Fargo Foreign Funds Advisors, Wells Fargo Foreign Funds Management, S.A., and Mortgage Capital Partners. Petitioners are not aware of any parent companies or subsidiaries of respondents Fairmount Financial Corporation and Arthur-Magna, Inc.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iv

OPINIONS BELOW 1

JURISDICTION 1

STATUTES AT ISSUE 1

STATEMENT OF THE CASE 1

REASONS FOR GRANTING THE PETITION 5

I. THE NINTH CIRCUIT'S OPINION CONFLICTS WITH THE STANDARD ADOPTED BY OTHER CIRCUITS IN CASES ALLEGING FRAUD BY HINDSIGHT 5

II. THE NINTH CIRCUIT'S OPINION CONFLICTS WITH THE STANDARD ADOPTED BY OTHER CIRCUITS FOR PLEADING SCIENTER IN SECURITIES FRAUD CASES 9

III. THE NINTH CIRCUIT'S OPINION REPRESENTS A MISAPPLICATION OF THIS COURT'S HOLDING IN *VIRGINIA BANKSHARES* 12

IV. THIS COURT'S GUIDANCE REGARDING THRESHOLD PLEADING STANDARDS IN SECURITIES CLASS ACTIONS IS OF VITAL SIGNIFICANCE TO LITIGANTS AND THE LOWER COURTS 14

CONCLUSION 17

TABLE OF AUTHORITIES

Page(s)

Cases

Anderson v. Liberty Lobby, Inc.,
477 U.S. 242 (1986) 17

Blue Chip Stamps v. Manor Drug Stores,
421 U.S. 723 (1975) 14-15, 16, 17

Celotex Corp. v. Catrett,
477 U.S. 317 (1986) 17

Central Bank, N.A. v. First Interstate Bank, N.A.,
114 S. Ct. 1439 (1994) 15, 17

Christidis v. First Pennsylvania Mortgage Trust,
717 F.2d 96 (3d Cir. 1983) 3, 8

Connecticut Nat'l Bank v. Fluor Corp.,
808 F.2d 957 (2d Cir. 1987) 10 n.9

Denny v. Barber,
576 F.2d 465 (2d Cir. 1987) 3, 8

DiLeo v. Ernst & Young,
901 F.2d 624 (7th Cir.),
cert. denied, 498 U.S. 941 (1990) ..... *passim*

Ernst & Ernst v. Hochfelder,
425 U.S. 185 (1976) 9, 12

Greenstone v. Cambex Corp.,
975 F.2d 22 (1st Cir. 1992) ..... 10 & n.9, 12 n.10

Hanna v. Plumer,
380 U.S. 460 (1965) 17

In re GlenFed, Inc. Sec. Litig.,
12 F.3d 893 (9th Cir. 1993),
reh'g en banc granted, No. 92-55419,
1994 U.S. App. LEXIS 3331
(9th Cir. Feb. 25, 1994) 8 n.7

In re Time Warner, Inc. Sec. Litig.,
9 F.3d 259 (2d Cir. 1993) 13, 14

In re VeriFone Sec. Litig.,
11 F.3d 865 (9th Cir. 1993) 6

Kowal v. MCI Communications Corp.,
16 F.3d 1271 (D.C. Cir. 1994) 6, 13, 14

Larson v. Domestic & Foreign Corp.,
337 U.S. 682 (1949)..... 14

Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,
475 U.S. 574 (1986) 17

Mayer v. Myloa,
988 F.2d 635 (6th Cir. 1993) 12 n.11

O'Brien v. National Property Analysts Partners,
936 F.2d 674 (2d Cir. 1991) 12 n.10

Raab v. General Physics Corp.,
4 F.3d 286 (4th Cir. 1993) 13

Robin v. Arthur Young & Co.,
915 F.2d 1120 (7th Cir. 1990) 10 n.9, 12 n.10

Romani v. Shearson Lehman Hutton,
929 F.2d 875 (1st Cir. 1991) 6

Roots Partnership v. Lands' End, Inc.,
965 F.2d 1411 (7th Cir. 1992) 6

Shapiro v. UJB Fin. Corp.,
964 F.2d 272 (3d Cir.),
cert. denied, 113 S. Ct. 365 (1992) 12 n.11

Sinay v. Lamson & Sessions Co.,
948 F.2d 1037 (6th Cir. 1991) 6

Tuchman v. DSC Communications Corp.,
14 F.3d 1061 (5th Cir. 1994) 10-11, 12 n.10

Virginia Bankshares, Inc. v. Sandberg,
111 S. Ct. 2749 (1991) ..... 4, 12 & n.11, 13, 14

Wexner v. First Manhattan Co.,
902 F.2d 169 (2d Cir. 1990) 10

Wilkes v. Heritage Bancorp, Inc.,
767 F. Supp. 1166 (D. Mass. 1991) 9

Statutes and Rules

Securities Exchange Act of 1934,
section 10(b), 15 U.S.C. § 78j(b) 9
section 27, 15 U.S.C. § 78aa 2 n.2

28 U.S.C.
§ 1254.1 1
§ 1367 ..... 2 n.2

Fed. R. Civ. P.
Rule 9(b) ..... *passim*
Rule 12(b) 1
Rule 12(b)(6) ..... *passim*

Securities and Exchange Commission Rule 10b-5,
17 C.F.R. § 240.10b-5 ..... 12, 15

Other Authorities

Janet C. Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions,* 435 Stan. L. Rev. 497 (1991) 14 n.12

1992 Annual Report of the Director of the Administrative Office of the United States Courts, Table C-2 .... 16 n.14

Bank Credit (H.V. Prochnow ed. 1981) 7

10 Banking Policy Report, No. 23 (Dec. 2, 1991) 15 n.13

Brent Bowers and Udayan Gupta, *Shareholder Suits Beset More Small Companies,* Wall St. J., Mar. 9, 1994 16

Class Action Reports, Vol. 15, No. 4, Table 4 (1992) 16 n.14

Francis X. Conway and William A. Siegenhaler, *Loan Loss Reserves: Tax, Regulatory and Adequacy Issues,* 70 J. Comm. Bank Lending, No. 1 (1987) 7

N.Y. Times, Oct. 18, 1993, Sec. D, col. 6 ..... 9 n.8

Note, Using Rule 9(b) to Reduce Nuisance Securities Litigation, 99 Yale L.J. 1591 (1990) 16

Office of the Comptroller of the Currency,
Comptroller's Handbook for National Bank Examiners § 217.1 (1984) 7

Office of the Comptroller of the Currency,
Banking Circular 201 (Rev.),
5 Fed. Banking L. Rep. (CCH)
¶ 51,132 (Feb. 20, 1992) 7, 13

SEC Financial Reporting Release No. 28,
6 Fed. Sec. L. Rep. (CCH) ¶ 73,126
(Dec. 1, 1986) 7

Wall St. J., Nov. 17, 1993, Sec. C, col. 3 ..... 9 n.8

OPINIONS BELOW

This petition seeks review of the opinion of the Ninth Circuit Court of Appeals reversing dismissal of this shareholder class action and reinstating plaintiffs' Amended Complaint (the "complaint"). The opinion of the Court of Appeals is reported at 12 F.3d 922 (9th Cir. 1993). The opinion of the District Court for the Northern District of California is not published. The full text of the opinions appears in the Appendix beginning at pages a-1 and a-19, respectively.[1]

JURISDICTION

The judgment of the Court of Appeals was entered on December 29, 1993. A timely petition for rehearing and suggestion for rehearing *en banc* was denied on March 8, 1994. (a-24.) The judgment may be reviewed by this Court by writ of certiorari granted under 28 U.S.C. § 1254.1.

STATUTES AT ISSUE

This petition raises issues involving the proper construction of Rule 9(b) and Rule 12(b)(6) of the Federal Rules of Civil Procedure as applied to a motion to dismiss a shareholder class action complaint. The full text of Rule 9(b) and Rule 12(b) appears in the Appendix. (a-77.)

STATEMENT OF THE CASE

This case arises out of a fall in the price of Wells Fargo & Co. common stock following a June 25, 1991 announcement that Wells Fargo Bank would be adding $350 million to its loan loss reserve for the quarter ended June 30, 1991. (a-30.) The bank also announced that it would recognize $180 million in actual loan losses for that quarter, which was far below the existing $885 million loan loss reserve. (a-54; a-56.) Wells Fargo stock, which had been trading at a previous high of $97.00 per share, dropped from $81.50 to $74.00 per share on the news. (a-56.) The first of five class actions against

---

1. All citations with the "a-" prefix refer to petitioners' Appendix, filed herewith.

Wells Fargo and its officers and directors was filed in the United States District Court for the Northern District of California the day the reserve increase was announced.[2]

That complaint, as subsequently amended, claims that the defendants, who are officers or directors of Wells Fargo, knew or should have known that the loan loss reserve had been materially understated in Wells Fargo's 1990 Annual Report, filed March 5, 1991, and its first quarter 1991 Form 10-Q. The claimed fraud allegedly led to overstated profits and inflated stock prices for the sixteen-week period between March 5, 1991 and the June 25 announcement.[3]

The complaint does not contend that Wells Fargo's Annual Report or Form 10-Q inaccurately stated the loan loss reserve established by the bank. Rather, the complaint contends that the Annual Report falsely stated that the reserve was "adequate," and failed to disclose the status of loans that defendants knew were "in jeopardy." (a-47; a-54.) Other than naming nine representative borrowers, the complaint contains no allegations of how the reserve failed properly to reflect the loans, or in what respect loans were "in jeopardy." (a-47.)

The complaint alleges that defendant officers and directors knew or should have known of unspecified problems, and were motivated to conceal those problems — through delaying an increase in the loan loss reserve — by their desire to maximize earnings, job security, and the value of their Wells Fargo stockholdings. (a-38; a-69.) The complaint does not allege how defendants became aware of these problems, or even identify, except in conclusory fashion, what the

---

2. The District Court's jurisdiction was based on section 27 of the Securities Exchange Act of 1934 (15 U.S.C. § 78aa) and principles of supplemental jurisdiction (28 U.S.C. § 1367).

3. The complaint alleges that the bank, like all other banks, is required to maintain a loan loss reserve, which the bank adjusts each quarter to maintain the reserve "at an appropriate level consistent with the risk of loss actually faced." (a-45.) Because each quarter's loan loss provision is charged against current income, an alleged understatement of the provision, and hence the reserve, results in an alleged overstatement in earnings.

problems allegedly were. Nor does the complaint allege that defendants sold Wells Fargo stock in anticipation of the reserve increase or earned some other benefit solely by delaying recognition of the alleged problems.

Defendants moved to dismiss the complaint under Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure. (a-25 to a-26.) The District Court granted the motion with prejudice, stating that "[n]othing in plaintiffs' voluminous complaint states facts which support a coherent theory of securities fraud." (a-20.)

A three-judge panel of the Ninth Circuit reversed in a split decision, with Judge Trott dissenting. The majority held that the disclosure of a loan loss reserve, while literally accurate, could be actionable if, as the complaint alleged, "Wells Fargo's statement of its loan loss reserves failed to disclose — *i.e.*, failed to reflect — certain loans that Wells Fargo knew were 'in jeopardy.'" (a-5.) The majority, noting that the District Court had not based dismissal on Rule 9(b) (a-2 n.1), ignored the requirements of that rule in assessing the sufficiency of the complaint's allegations, and concluded that the complaint contained sufficient facts to support an inference that the loan loss reserve had been fraudulently understated.

The majority acknowledged that other courts of appeals hold that a plaintiff must allege "something more" than an increase in a bank's loan loss reserve to state a claim for securities fraud. (a-6.) *See, e.g., Denny v. Barber*, 576 F.2d 465 (2d Cir. 1978); *Christidis v. First Pennsylvania Mortgage Trust*, 717 F.2d 96 (3d Cir. 1983); *DiLeo v. Ernst & Young*, 901 F.2d 624 (7th Cir.), *cert. denied*, 498 U.S. 941 (1990). According to the majority, plaintiffs met that standard by listing in a conclusory fashion nine HLT loans "which, in their view,

Wells Fargo should have recognized by adjusting its reserves accordingly." (a-5; a-6.) [4]

The majority found further support for plaintiffs' claims in the allegation that Wells Fargo's Annual Report set forth management's *belief* that the loan loss reserve was "adequate," and that some of the loans were "substantially secured." (a-12.) Relying on this Court's decision in *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749 (1991), the majority ruled that these statements were potentially actionable statements of belief, and that plaintiffs could proceed on the theory that management had no basis for believing the statements to be true when they were made. (a-12.)

Finally, the majority held that the conclusory allegation that officers and directors "became aware" of foreseeable problems in the loan portfolios, and were motivated to delay an increase in the reserve to "maximize" their compensation and job security, was a sufficient averment of scienter. (a-3; a-14.)

Judge Trott dissented, noting that on the date of oral argument in the Ninth Circuit, Wells Fargo stock was trading at $104.75 per

---

4. The allegations about the nine borrowers are remarkable for their generality. The complaint states in pertinent part:

> When the promoters of HLTs [highly leveraged transactions] and real estate developers began to experience financial difficulties and/or problems in repaying the loans prior to and at the beginning of the Class Period, Defendants were on notice that a substantial portion of Wells Fargo's outstanding HLT Loans and real estate loans were in jeopardy, particularly in light of the information that was available to the Individual Defendants as sophisticated officers and directors of this major bank holding company.
>
> []. Defendants, however, did not disclose these facts nor did they establish adequate provisions for loan losses on these loans. *Among the high-risk HLT Loans for which Defendants were on notice of these problems were, inter alia, Revco D.S., Insilco Corp., Charter Medical Group, R.H. Macy & Co., Campeau Corp., Jim Walters Corp., Gaylord Container Corp., West Point Pepperell, Inc., and NWA, Inc.*

(a-47; emphasis added.)

share, higher than the pre-announcement high.[5] Judge Trott observed, "This is an interesting kind of fraud where the value of the disputed stock before the case goes to trial exceeds its value before the alleged wrongdoing that caused it to 'collapse.'" (a-17.) Judge Trott agreed with the District Court that "'[t]he fact that defendants increased loan loss reserves in the second quarter, and at all times relevant accurately reported the amount of actual reserves set aside by the bank, does not by itself allege securities fraud, notwithstanding conclusory statements of fraud in the complaint.'" (a-16.) Judge Trott further agreed that the fact that plaintiffs were able to "'list customers of the Bank who are known today to be burdened with debt'" adds nothing to a complaint which alleges no more than "'fraud by hindsight.'" (a-16 to a-17.)

The Ninth Circuit denied defendants' petition for rehearing and suggestion for rehearing *en banc* on March 8, 1994. (a-24.)

REASONS FOR GRANTING THE PETITION

I. THE NINTH CIRCUIT'S OPINION CONFLICTS WITH THE STANDARD ADOPTED BY OTHER CIRCUITS IN CASES ALLEGING FRAUD BY HINDSIGHT

The Ninth Circuit found that the crux of plaintiffs' complaint was their claim that the extraordinary increase in Wells Fargo's loan loss reserve on June 25, 1991 should have been made three months earlier. (a-3.) The Ninth Circuit's holding that these conclusory allegations were sufficient to state a claim for securities fraud is contrary to holdings in other similar loan loss reserve cases, and to a far broader category of cases involving forward-looking statements in general.[6]

---

5. On June 2, 1994, Wells Fargo's closing stock price was $156.50 per share.

6. As used herein, the term "forward-looking statement" refers to any statement used by a corporation or its management regarding future developments. For example, disclosures of financial forecasts, predictions of economic trends, and management's plans for future operations are types of forward-looking statements.

Decisions from other circuits reject claims of fraud by hindsight based on forward-looking statements. These courts hold that to state a cause of action based on a forward-looking statement, securities fraud plaintiffs must plead *facts* which, if true, would establish that the forward-looking statement lacked a reasonable basis. *See, e.g., Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 878 (1st Cir. 1991); *Sinay v. Lamson & Sessions Co.*, 948 F.2d 1037, 1042 (6th Cir. 1991). *See also In re VeriFone Sec. Litig.*, 11 F.3d 865, 871 (9th Cir. 1993).

For example, in *Kowal v. MCI Communications Corp.*, 16 F.3d 1271, 1278 (D.C. Cir. 1994), the Court of Appeals for the District of Columbia affirmed dismissal of a complaint alleging that a forward-looking statement was fraudulent. As in this case, the complaint "point[ed] to the 'gross deviation' between the results actually achieved by MCI and the results that MCI predicted would be achieved." The court emphatically rejected this "theory" of fraud:

> The fact that the Company's performance did not conform to that predicted supports no inference that MCI's statements lacked a reasonable basis when made . . . . A failure to meet projected earnings or revenues "does not in itself suggest the goal fell outside the realm of reasonable probability and therefore lacked a reasonable basis."

Id. (citations omitted).

The court further held that conclusory allegations of undisclosed facts, which purportedly undermine the basis for the forward-looking statement, are insufficient to state a claim for securities fraud. *Id.* at 1279; *see also Roots Partnership v. Lands' End, Inc.*, 965 F.2d 1411, 1418 (7th Cir. 1992).

Similarly, courts of appeals outside the Ninth Circuit hold that a complaint basing a securities fraud claim on the increase in a bank's loan loss reserve does not support an inference of fraud. As these courts recognize, the vice of permitting plaintiffs to proceed on a theory of fraud by hindsight is exacerbated in a case challenging an extraordinary increase in a bank's loan loss reserve. A reserve for loan losses appears on every bank's financial statement as a deduction from the value of the loan portfolio. Every bank is required to evaluate the collectibility of loans in its portfolio at a given time, and reserve an

amount adequate to absorb anticipated losses. Office of the Comptroller of the Currency, Banking Circular 201 (Rev.), 5 Fed. Banking L. Rep. (CCH) ¶ 51,132, at 30,133-4 (Feb. 20, 1992). According to the regulators, the reserve should include only losses "that probably exist[] based on information that is available as of the evaluation date." The amount of the loss "must be subject to reasonable estimation," and should not include "losses that may occur as a result of possible future events." *Id.* at n.1.

The Office of the Comptroller of the Currency, the Securities and Exchange Commission, and commentators all recognize that, unlike objective entries on a financial statement such as inventory and sales, the calculation of the loan loss reserve is inherently subjective. It has been described as "an art and not a science," which "necessarily involves a high degree of management judgment." SEC Financial Reporting Release No. 28, 6 Fed. Sec. L. Rep. (CCH) ¶ 73,126, at 62,760 (Dec. 1, 1986); Francis X. Conway and William A. Siegenhaler, *Loan Loss Reserves: Tax, Regulatory and Adequacy Issues*, 70 J. Comm. Bank Lending, No. 1, at 15 (1987). There is "no way to assure complete accuracy" in setting a loan loss reserve. 70 J. Comm. Bank Lending, No. 1, at 10. *See also* Office of the Comptroller of the Currency, *Comptroller's Handbook for National Bank Examiners* § 217.1, at 2 (1984).

In addition, each statement of the loan loss reserve relates to a new period. Because the loan loss reserve "is only understood in a dynamic sense," *Bank Credit* 356 (H.V. Prochnow ed. 1981), a change in the loan loss reserve from period to period is the rule, not the exception, and says nothing about the adequacy of the reserve during an earlier period.

Thus, courts of appeals outside the Ninth Circuit reject hindsight claims that loan losses had been "fraudulently understated," based on subsequent reserve increases. For example, in *DiLeo v. Ernst & Young*, 901 F.2d 624, 626 (7th Cir.), *cert. denied*, 498 U.S. 941 (1990), the complaint alleged that before the understated loan loss reserve was disclosed to prospective shareholders, defendants "'became aware that a substantial amount of the receivables reported in Continental's financial statements were likely to be uncollectible.'" *Id.* The court

observed, "If all that is involved is a dispute about the timing of the write-off, based on estimates of the probability that a particular debtor will pay, we do not have fraud; we may not even have negligence." *Id.* at 627. The court concluded that the plaintiffs had failed to allege facts which, if true, would show "that the problems were so apparent that reserves should have been jacked up before the end of 1983 — why failure to increase the reserves amounted to 'fraud.'" *Id.*

The Second and Third Circuits have rejected similar claims of "fraud by hindsight," holding that an extraordinary increase in a bank's loan loss reserve does not, standing alone, state a claim for securities fraud. *See, e.g., Denny v. Barber*, 576 F.2d 465 (2d Cir. 1978); *Christidis v. First Pennsylvania Mortgage Trust*, 717 F.2d 96 (3d Cir. 1983).[7]

While the Ninth Circuit paid lip service to these decisions, its holding cannot be reconciled with them. The Ninth Circuit, acknowledging that "something more" was required than just an extraordinary increase in the reserve, found "something more" in plaintiffs' conclusory allegation that loans to nine named borrowers were "in jeopardy." (a-5; a-6.) Conclusory, vague allegations about nine loans do not explain or support plaintiffs' theory of fraud any more than do conclusory, vague allegations about the bank's loan portfolio as a whole. The complaint contains no facts supporting the assertion that the nine loans were "in jeopardy," much less that there were any losses of principal or interest, or contractual defaults. Moreover, even if the nine loans named by plaintiffs were "in jeopardy" in March of 1991, that would not prove that the reserve was fraudulently understated, since there is no allegation either that defendants failed to consider the nine loans in establishing the loan loss reserve

---

7. The opinion in this case also conflicts with the decision by another Ninth Circuit panel in *In re GlenFed, Inc. Sec. Litig.*, 11 F.3d 843 (9th Cir. 1993). In that case, the Ninth Circuit held that similar allegations that a bank had knowingly understated its loan loss reserve did not raise an inference of fraud. That decision is currently being reviewed by the Ninth Circuit *en banc*. 1994 U.S. App. LEXIS 3331 (9th Cir. 1994) (No. 92-55419).

in the first quarter of 1991, or that those nine loans accounted for the second quarter reserve increase.

Indeed, in this case, even hindsight does not work in plaintiffs' favor. While it may have appeared during the 1991 recession that Wells Fargo and other banks had under-reserved in 1990 and early 1991, and bank stock prices fell as a result, stock prices have recovered beyond pre-recession highs. Analysts now believe that Wells Fargo and other banks *over-reserved* in 1990 and 1991.[8]

Finally, the Ninth Circuit improperly ignored the requirements of Rule 9(b) in ruling on the adequacy of the complaint in this case. The Ninth Circuit opinion does not mention Rule 9(b), except to point out that the District Court's dismissal was based on Rule 12(b)(6). (a-2 & n.1.) Although defendants moved under both Rules (a-26), the District Court did not reach the additional requirements of Rule 9(b), given its conclusion that the complaint did not pass muster under Rule 12(b)(6). (a-20 to a-21.) The Ninth Circuit should not have ended its inquiry after it reached the opposite conclusion regarding Rule 12(b)(6); it was required to consider Rule 9(b), since the motion to dismiss was based on both Rules, and since a plaintiff must comply with both Rules to state a claim for securities fraud. *See, e.g., Wilkes v. Heritage Bancorp, Inc.*, 767 F. Supp. 1166, 1169 (D. Mass. 1991).

II. THE NINTH CIRCUIT'S OPINION CONFLICTS WITH THE STANDARD ADOPTED BY OTHER CIRCUITS FOR PLEADING SCIENTER IN SECURITIES FRAUD CASES

This Court held in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976), that to plead a violation of section 10(b), a plaintiff must allege facts raising an inference of scienter — an "intent to deceive, ma-

---

8. *See, e.g.*, Wall St. J., Nov. 17, 1993, Sec. C at 2, col. 3 ("many believe that Wells Fargo is now enormously over-reserved — to the tune of $1 billion, by some estimates"); N.Y. Times, Oct. 18, 1993, Sec. D at 1, col. 6 ("bad loans in 1990 and 1991 were overstated to such a degree that [banks] can now recoup some of the charges that caused big losses in earlier years").

nipulate, or defraud." The only "facts" cited by the Ninth Circuit regarding scienter are plaintiffs' conclusory allegations that defendants "became aware" that problems in Wells Fargo's loan portfolio were foreseeable, and were motivated to delay disclosure

> by the desire to "continue and prolong the image of Wells Fargo as a well-managed enterprise with sound lending procedures" and thus, maximize their individual compensation, the value of their personal Wells Fargo & Co. stock holdings, and their job security.

(a-3.) The Ninth Circuit held that these conclusory allegations were sufficient to satisfy the scienter element of plaintiffs' claim. (a-14.)

Once again, that holding directly conflicts with recent decisions from other circuits. *See, e.g., Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1067-69 (5th Cir. 1994); *Wexner v. First Manhattan Co.*, 902 F.2d 169, 172 (2d Cir. 1990); *Greenstone v. Cambex Corp.*, 975 F.2d 22, 25 (1st Cir. 1992); *DiLeo v. Ernst & Young*, 901 F.2d at 627.[9]

For example, in *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061 (5th Cir. 1994), the complaint alleged that defendants were motivated by their desire to keep their jobs, increase their compensation, and inflate the value of their shares in the company. The Fifth

---

9. Rule 9(b) provides that while a person's state of mind may be alleged generally, "the circumstances constituting fraud or mistake shall be stated with particularity." In *Connecticut Nat'l Bank v. Fluor Corp.*, 808 F.2d 957 (2d Cir. 1987), the Second Circuit explained how the two clauses are reconciled:

> The absence of a requirement that scienter be alleged with "great specificity" is based on the premise that a plaintiff realistically cannot be expected to plead a defendant's actual state of mind. This does not mean, however, that plaintiffs are relieved of their burden of pleading circumstances that provide at least a minimal factual basis for their conclusory allegations of scienter. "It is reasonable to require that the plaintiffs specifically plead those events" which "give rise to a strong inference" that the defendants had an intent to defraud, knowledge of the falsity, or a reckless disregard for the truth.

Id. at 962 (citations omitted). *See also Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1127 (7th Cir. 1990); *Greenstone*, 975 F.2d at 25.

Circuit held that those allegations did not "set out facts sufficient to lead to a proper inference of scienter." *Id.* at 1068. The Fifth Circuit observed that "'were the opposite true, the executives of virtually every corporation in the United States would be subject to fraud allegations'." *Id.* Similarly, in *DiLeo*, the Seventh Circuit concluded that it made no sense to infer that the accountants who audited financial statements of a client had engaged in a fraud:

> An accountant's greatest asset is its reputation for honesty, followed closely by its reputation for careful work. Fees for two years' audits could not approach the loss E & W would suffer from a perception that it would muffle a client's fraud.

901 F.2d at 629.

The decision by the Ninth Circuit that the complaint adequately pleads scienter is a radical and unwise departure from these well-reasoned decisions. Under the rule expressed in this case, an inference of fraudulent intent can be drawn from facts that are entirely consistent with innocent conduct. The complaint does not allege that the content or timing of Wells Fargo's disappointing financial disclosures made any difference in the individual defendants' job security or compensation. Nor does the complaint allege that Wells Fargo insiders sold stock in anticipation of the reserve increase. Absent such allegations, it does not logically follow that a temporary delay of an increase in Wells Fargo's loan loss reserve would benefit any of the officer and director defendants. If anything, logic supports the opposite inference — it would be irrational for bank executives knowingly and

intentionally to understate the bank's loan loss reserve. *See DiLeo*, 901 F.2d at 629.[10]

If, as the Ninth Circuit held, plaintiffs can base a charge of securities fraud on scienter allegations no more consistent with dishonest than with innocent conduct, they can impose the tremendous cost of discovery and motion practice — not to mention grievous injury to reputation — on individuals of whom there is *no reason to suspect fraud*. That disserves the investing community generally, and is contrary to Rule 9(b) and to this Court's directive that a defendant may not be found liable under Rule 10b-5 "unless he acted other than in good faith." *Hochfelder*, 425 U.S. at 206.

III. THE NINTH CIRCUIT'S OPINION REPRESENTS A MISAPPLICATION OF THIS COURT'S HOLDING IN *VIRGINIA BANKSHARES*

The Ninth Circuit concluded that this case was governed by *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2758 n.6 (1991), because the complaint alleges that Wells Fargo's Annual Report stated management's *belief* that the loan loss reserve was "adequate" and that HLT loans were "substantially secured." (a-12 to a-13.)[11] Even if *Virginia Bankshares* could apply to such a statement of management belief, the Ninth Circuit erred in concluding that the complaint adequately pleaded that these statements were fraudulent.

---

10. Absent sufficient allegations of motive, scienter can be pleaded by alleging particularized facts supporting an inference that defendants knew or should have known of the fraud. No such particularized facts can be found in the complaint. To the extent the Ninth Circuit held that plaintiffs satisfied the scienter requirement with conclusory allegations that defendants "became aware" of problems with the bank's loan portfolio, its holding likewise conflicts with the other circuits' views of minimum requirements for pleading scienter. *See, e.g., Greenstone*, 975 F.2d at 25; *O'Brien v. National Property Analysts Partners*, 936 F.2d 674, 676 (2d Cir. 1991); *Tuchman*, 14 F.3d at 1068; *Robin*, 915 F.2d at 1127.

11. While the opinion does not cite *Virginia Bankshares* for this proposition, it does cite decisions that relied on *Virginia Bankshares* to find statements of opinion actionable. *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 282 (3d Cir.), *cert. denied*, 113 S. Ct. 365 (1992); *Mayer v. Mylod*, 988 F.2d 635, 639 (6th Cir. 1993).

While *some* statements of management's belief *can* be actionable under *Virginia Bankshares*, that holding does not immunize claims based on allegedly fraudulent statements of management's belief from compliance with minimum pleading requirements under Rules 9(b) and 12(b)(6). To the contrary, *Virginia Bankshares* did not change or even address threshold pleading requirements in securities fraud cases. *Virginia Bankshares* certainly did not change the rule that *conclusory* attacks on statements of belief or opinion fail as a matter of law. *See, e.g., Kowal v. MCI Communications Corp.*, 16 F.3d 1271, 1277-79 (D.C. Cir. 1994); *In re Time Warner, Inc. Sec. Litig.*, 9 F.3d 259, 266 (2d Cir. 1993).

Plaintiffs' allegation that management falsely stated its *belief* that the loan loss reserve was adequate is no more particularized than an allegation that the reserve itself was fraudulently understated. Certainly such an allegation raises no inferences in addition to or different from those arising from reporting the loan loss reserve as a line item in the bank's financial statement without editorial comment. Either way, the alleged misrepresentation rests on the same unwarranted inference — that the increase in the reserve *must be* due to fraud. As discussed in Section I, above, the mere fact that the loan loss reserve increased says nothing about whether the previous reserve was adequate. If the rule were otherwise, every increase in the loan loss reserve would be grounds for a shareholder lawsuit, since every statement of the reserve contains an implied representation that management believes the reserve to be adequate. *See* OCC Banking Circular 201 (Rev.), 5 Fed. Banking L. Rep. (CCH) ¶ 51,132, at 30,133-4 (Feb. 20, 1992). *See also Raab v. Gerard*, 4 F. 3d 286, 290 (4th Cir. 1993).

Nor does an allegation that management stated its *belief* that loans to HLT borrowers were substantially secured add anything to plaintiffs' allegations. Once again, whether the statement is viewed as one of fact or of opinion, plaintiffs' allegation is wholly conclusory. Plaintiffs allege no particularized facts showing that HLT loans were not substantially secured, much less that management knew or should have known those alleged facts. While the complaint does at one point identify nine well-known HLT borrowers (a-47), the complaint does not allege how significant those nine loans were in rela-

tion to the size of the reserve, to the size of the overall portfolio, or even to any narrower category of loans. Nor does the complaint allege that those nine loans were not substantially secured.

Whether the challenged statements are characterized as fact or opinion, the complaint was therefore subject to dismissal for failure to state a claim under both Rule 9(b) and Rule 12(b)(6). The Ninth Circuit's apparent conclusion that statements of opinion should be held to a lesser pleading standard than statements of fact is an unwarranted extension of *Virginia Bankshares*, which conflicts with decisions from other circuits such as *Kowal* and *In re Time Warner*.

IV. THIS COURT'S GUIDANCE REGARDING THRESHOLD PLEADING STANDARDS IN SECURITIES CLASS ACTIONS IS OF VITAL SIGNIFICANCE TO LITIGANTS AND THE LOWER COURTS

Respondents will no doubt argue that there will be time enough for this Court to review this case following entry of final judgment. That argument ignores the substantial burden imposed on the lower courts and on businesses in general by shareholder class action litigation. It also ignores the reality that the overwhelming majority of companies (and their officers and directors) named as defendants in these cases settle, rather than face the expense, disruption and uncertainty of vindicating their position on the merits.[12] In any event, this Court has held that it is appropriate to review a case in this posture, since the issues raised in this petition are "'fundamental to the further conduct of the case.'" *Larson v. Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 685 n.3 (1949).

As this Court has recognized, the costs of allowing a securities fraud case to proceed beyond the pleadings stage are great. *Blue Chip*

---

12. *See* Janet C. Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 435 Stan. L. Rev. 497, 525-26 (1991) ("no more than two securities class actions involving public corporations went to trial in federal court in the United States during 1987. . . . [S]ecurities class actions are adjudicated considerably less often than other types of cases").

Stamps v. Manor Drug Stores, 421 U.S. 723, 739 (1975) ("litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general"). This Court has also recognized that the costs of defending these suits, and the disruption they can cause, impose a great financial burden on the very shareholders that Rule 10b-5 was intended to benefit. *See Central Bank, N.A. v. First Interstate Bank, N.A.*, 114 S. Ct. 1439, 1454 (1994).

That concern applies with special force to litigation over an alleged understatement of a bank's loan loss reserve, given the nature of the discovery that plaintiffs can be expected to pursue. In an action based on conclusory allegations of an increase in the loan loss reserve, plaintiffs' proposed discovery will likely seek production of every loan file maintained by the bank, in an effort to show that a particular credit should have been, but was not, reflected in the reserve. The time period covered by such discovery will likely be expansive under a theory that the bank's historical experience with particular borrowers or industries bears on the adequacy of current reserves. In addition, plaintiffs will likely seek to depose every witness associated with setting the reserve or generating or reviewing any problem loans. For any bank, responding to such discovery would be both burdensome and disruptive, leading many banks to settle groundless suits to avoid the costs of defense.[13]

This Court has voiced concern about the social cost of corporations paying large amounts to settle meritless suits, based on their nuisance value:

> To the extent that [the discovery process] permits a plaintiff with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the pro-

---

13. Many banks are now faced with similar lawsuits arising out of increases to their loan loss reserves during the recent recession. More than one hundred lawsuits were filed from 1989 to 1991 challenging the timing of increases in loan loss reserves. *See* 10 Banking Policy Report, No. 23, at 1 (Dec. 2, 1991).

> cess will reveal relevant evidence, it is a social cost rather than a benefit.

Blue Chip Stamps, 421 U.S. at 741. Since *Blue Chip Stamps* was decided, the price attached to this "social cost" has risen at a staggering rate. The total amount paid to settle shareholder class actions in 1992 was $1.55 billion, more than five times the amount in 1988. The number of such settlements increased from 53 in 1988, to 144 in 1992, and the average cash settlement increased from $6.1 million to $10.8 million. Brent Bowers and Udayan Gupta, *Shareholder Suits Beset More Small Companies*, Wall St. J., Mar. 9, 1994, at B1.[14]

Another social cost imposed by the lower courts' inability to dismiss meritless securities fraud claims at the pleadings stage is erosion of public confidence in the courts:

> The securities nuisance litigation-settlement cycle constitutes abuse of process by the plaintiff's bar at the expense of target defendants' shareholders and customers. To fund the settlement of non-meritorious suits, defendants may need to reduce or eliminate dividends to their shareholders, take an earnings "hit," and/or raise product prices and pass the cost on to the consuming public. In addition, this misappropriation receives a legal imprimatur that ultimately undermines public confidence in the legal system.

Note, *Using Rule 9(b) to Reduce Nuisance Securities Litigation*, 99 Yale L.J. 1591, 1600 (1990) (footnote omitted).

Rules 9(b) and 12(b)(6) are the most effective procedural devices for reducing these social costs. The significance of these rules in the overall context of securities litigation cannot be overstated. Properly applied, Rules 9(b) and 12(b)(6) permit the district courts to sift through boilerplate allegations and eliminate those securities fraud complaints that lack a factual basis, before huge litigation costs are in-

---

14. The most recent figures show that 2,002 new securities cases were filed in the federal courts for the year ending September 30, 1992, 268 of which were class actions. 1992 Annual Report of the Director of the Administrative Office of the United States Courts, Table C-2, at 178-79; *Class Action Reports*, Vol. 15, No. 4, Table 4, at 389 (1992).

curred. Thus, district courts can dismiss groundless lawsuits and prevent "disruption of normal business activities" through "abuse of the liberal discovery provisions of the Federal Rules of Civil Procedure," which is of particular concern in this type of case. *Blue Chip Stamps*, 421 U.S. at 741, 742-43.

The circuit conflict over threshold pleading standards in securities class actions has created confusion in the lower courts regarding what test to apply in deciding when to dismiss such complaints. *Cf. Central Bank, N.A. v. First Interstate Bank, N.A.*, 114 S.Ct. 1439, 1454 (1994) (recognizing the importance of certainty and predictability in the rules for determining civil liability for securities fraud). Review to resolve this conflict is particularly appropriate because it involves interpretation of a provision of the Federal Rules of Civil Procedure that this Court has never addressed. *See, e.g., Hanna v. Plumer*, 380 U.S. 460, 463 (1965) (granting certiorari "[b]ecause of the threat to the goal of uniformity of federal procedure posed by the decision below"). This Court should issue the writ to clarify the authority of the district courts to terminate meritless lawsuits like this one at the pleading stage, and avoid the imposition of costly discovery and summary judgment motion practice, as well as prolonged injury to reputation, upon defendants who are innocent of any wrongdoing.

CONCLUSION

Judge Trott predicted in his dissenting opinion below that "[w]hen businesses complain about the costs heaped on them by a court system with no adequate controls, I believe they will be able to point to this litigation as an example." (a-18.) The time has come for this Court to give much needed guidance on what pleading standards to apply to these cases. In recent years, the Court has provided invaluable guidance regarding the standards governing motions for summary judgment in complex commercial cases. *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986). The Court should issue the writ to provide similar guidance at the pleading stage.

For the foregoing reasons, petitioners respectfully request the Court to grant certiorari to reverse the opinion of the Ninth Circuit and to reinstate the judgment of the District Court dismissing this action with prejudice.

Dated: June 6, 1994.

MELVIN R. GOLDMAN*
JACK W. LONDEN
PAUL FLUM
CAROLYN A. JOHNSTON
MORRISON & FOERSTER

Attorneys for Petitioners

* *Counsel of Record*

FILED
JUN - 6 1994
OFFICE OF THE CLERK

No. 93-1993

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1993

IN RE WELLS FARGO SECURITIES LITIGATION

WELLS FARGO & CO., *et al.*,
Petitioners,

v.

HOWARD GREENWALD, *et al.*,
Respondents.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

APPENDIX TO PETITION FOR WRIT OF CERTIORARI

MELVIN R. GOLDMAN*
JACK W. LONDEN
PAUL FLUM
CAROLYN A. JOHNSTON
MORRISON & FOERSTER
345 California Street
San Francisco, CA 94104
(415) 677-7000

Attorneys for Petitioners

**Counsel of Record*

TABLE OF CONTENTS

Page

In re Wells Fargo Securities Litigation, 12 F.3d 922 (9th Cir. 1993) a-1

Order Granting Defendants' Motion to Dismiss, United States District Court, Northern District of California, December 21, 1991 ..... a-19

Order re: Denial of Defendants' Petition for Rehearing, United States Court of Appeals for the Ninth Circuit, March 8, 1994 ..... a-24

Notice of Motion and Motion to Dismiss the Amended Class Action Complaint, September 30, 1991 ..... a-25

Amended Class Action Complaint for Damages for Violations of the Federal Securities Laws; Fraud and Negligent Misrepresentation, August 26, 1991 ..... a-27

Rules Involved a-77

In re WELLS FARGO SECURITIES LITIGATION.

Howard GREENWALD; Milton Friedman; Sheldon Shore; John Paul Decker; Fairmont Financial Corporation; Arthur-Magna Inc; Harold Bloch; Robert C. Schilling, on behalf of themselves and all others similarly situated, Plaintiffs-Appellants,

v.

WELLS FARGO & CO., a Delaware Corporation; Carl E. Reichardt; Paul Hazen; Robert L. Joss; Clyde Ostler; David M. Petrone; William F. Zuendt; Stephen A. Enna; Rodney L. Jacobs; Patrick W. Leahy; Guy Rounsaville, Jr., Defendants-Appellees.

No. 92-15344.

United States Court of Appeals,

Ninth Circuit.

Argued and Submitted May 10, 1993.

Decided Dec. 29, 1993.

William S. Lerach, Milberg, Weiss, Bershad, Hynes & Lerach, San Diego, CA, and Elizabeth Joan Cabraser, Lieff, Cabraser & Heimann, San Francisco, CA, for plaintiffs-appellants.

Melvin R. Goldman, Morrison & Foerster, San Francisco, CA, for the defendants-appellees.

Appeal from the United States District Court for the Northern District of California.

Before: REINHARDT, TROTT, and RYMER, Circuit Judges.

RYMER, Circuit Judge:

Purchasers of Wells Fargo & Co. common stock ("shareholders") appeal from the district court's order dismissing their securities fraud class action with prejudice pursuant to Federal Rule of Civil Procedure 12(b)(6).[1] In their Amended Complaint, the shareholders allege that Wells Fargo & Co. and certain of its senior officers and directors (collectively "Wells Fargo") violated § 10(b) of the Securities Exchange Act of 1934 ("'34 Act"), 15 U.S.C. § 78j(b); the SEC's Rule 10b-5, 17 C.F.R. § 240.10b-5; § 20 of the '34 Act, 15 U.S.C. § 78t; and California Civil Code §§ 1709-10 by fraudulently withholding material information and by issuing a series of false and misleading statements relating to the level of loan loss reserves maintained by Wells Fargo & Co.'s banking subsidiary, Wells Fargo Bank.[2] The shareholders claim that these omissions and misrepresentations served to inflate artificially the trading price of Wells Fargo & Co. stock, thus causing financial injury to those who purchased the overpriced shares. We have jurisdiction under 28 U.S.C. § 1291, and we reverse.

I

On June 25, 1991, Wells Fargo & Co. issued a statement that Wells Fargo Bank would recognize $180 million in actual loan losses for the second quarter ending June 30, 1991, and that the Bank expected to add approximately $350 million to its loan loss reserves for that same period. Wells Fargo's disclosure precipitated a sharp drop in the trading price of its stock — from a pre-announcement high of $97 per share to $74 per share. Shareholders who purchased Wells Fargo stock between March 5, 1991, when the company issued its

---

1. Although the district court mentioned Fed. R. Civ. P. 9(b) in its opinion, both sides agree that it did not rely on Rule 9(b) in ordering dismissal.

2. In dismissing the shareholders' cause of action under § 10(b) and Rule 10b-5, the district court did not reach the merits of either the shareholders' § 20 claim or their California state law claims for fraud and negligent misrepresentation. Accordingly, the propriety of the district court's dismissal of the shareholders' claim for relief under § 10(b) and Rule 10b-5 is the only issue on appeal.

1990 Annual Report to Shareholders and filed its Form 10-K with the SEC, and June 25, 1991, the date that Wells Fargo disclosed that it would increase loan loss reserves for the second quarter, filed their amended class action complaint on August 26, 1991.

The theory of securities fraud advanced by the shareholders' Amended Complaint is that Wells Fargo maintained the inflated trading price of its common stock by failing to disclose the status of certain loans that it knew were in jeopardy. More specifically, the shareholders allege that senior directors and officers of Wells Fargo, motivated by the desire to "continue and prolong the image of Wells Fargo as a well-managed enterprise with sound lending procedures" and thus, maximize their individual compensation, the value of their personal Wells Fargo & Co. stock holdings, and their job security, became aware in March 1991 that the Bank's commercial, real estate, and highly leveraged loan portfolios had been mismanaged, were "not fundamentally sound and [were] prone to non-repayment in foreseeable and predictable economic downturns." Nonetheless, according to the shareholders, Wells Fargo was able to maintain the high value of its stock "through the issuance of materially false and misleading reports filed with the SEC, annual and quarterly reports to shareholders, releases to the public and financial statements," all intended to conceal "how poorly Wells Fargo had been managed by the Individual Defendants and how badly its financial and operating condition had deteriorated." Primary among Wells Fargo's alleged methods of deception was a deliberate understatement of loan loss reserves,[3] effected through Wells Fargo's failure timely to recognize known problem loans and failure to adjust loan loss reserves "at an appropriate level consistent with the [known] risk of loss actually faced."

In its Order Granting Defendants' Motion to Dismiss the shareholders' complaint for failure to state a claim, the district court held that "[n]othing in plaintiffs' voluminous complaint states facts which support a coherent theory of securities fraud." The court concluded

---

3. The Amended Complaint states that banks charge each quarter's provision for loan losses against current net income, thu .educing earnings per share in an amount corresponding to the increase in the reserve.

that the shareholders' Amended Complaint alleged non-actionable "fraud by hindsight," and characterized the shareholders' suit, purportedly based on a three-month conspiracy among the defendants to conceal or misrepresent the Bank's financial health by understating loan loss provisions, as one more accurately describing mismanagement by Wells Fargo, or perhaps a violation of the applicable banking regulations. As the district court explained, "[t]he fact that defendants increased loan loss reserves in the second quarter, and at all times relevant accurately reported the amount of actual reserves set aside by the bank, does not by itself allege securities fraud, notwithstanding conclusory statements of fraud in the complaint." Stating that the shareholders' Amended Complaint, "a collaborative effort by a dozen law firms with significant experience in [the] field of securities litigation," "cannot be further improved," the district court granted Wells Fargo's motion to dismiss the federal securities law causes of action with prejudice. Finally, pursuant to 28 U.S.C. § 1367(c)(3), the court declined to exercise its supplemental jurisdiction to hear the shareholders' two remaining state law claims.

II

A dismissal for failure to state a claim pursuant to Federal Rule of Civil Procedure 12(b)(6) is a ruling on a question of law and as such is reviewed de novo. *Oscar v. University Students Co-op. Ass'n*, 965 F.2d 783, 785 (9th Cir.) (en banc), *cert. denied*, ___ U.S. ___, 113 S.Ct. 655, 121 L.Ed.2d 581 (1992). All allegations of material fact are taken as true and construed in the light most favorable to the plaintiff. *Love v. United States*, 915 F.2d 1242, 1245 (9th Cir. 1989).

III
A

The shareholders contend that the allegation that Wells Fargo intentionally or recklessly understated its loan loss reserves in an effort to inflate corporate earnings (and therefore earnings per share), and then disseminated financial statements reflecting this misallocation to the public and to the SEC, states a claim under § 10(b) and Rule 10b-5. Noting that a bank's loan loss reserve is set based on the risk

of loss posed by the aggregate of a bank's loan transactions, the shareholders argue that the deliberate failure to recognize problem loans, thus understating the reserve, constitutes an actionable omission or misrepresentation of existing fact which cannot be dismissed as a mere matter of internal mismanagement, unsound business practice, or poor accounting judgment.

The shareholders are correct. To state a claim under § 10(b) and Rule 10b-5, the shareholders must allege that Wells Fargo knowingly or recklessly published an "untrue statement of fact" or omitted to state a material fact "necessary to make the statements made, in light of all the circumstances in which they were made, not misleading." *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1113 (9th Cir. 1989), *cert. denied*, 496 U.S. 943, 110 S.Ct. 3229, 110 L.Ed.2d 676 (1990). Wells Fargo's financial statements contain no "untrue statements of fact" — the shareholders do not dispute that Wells Fargo accurately disclosed the amount allocated by the Bank to its loan loss reserves. Thus, the shareholders must identify some omission of material fact necessary to make Wells Fargo's literally accurate reporting of the size of its reserve not misleading. In substance, the shareholders allege that Wells Fargo's statement of its loan loss reserves failed to disclose — *i.e.*, failed to reflect — certain loans that Wells Fargo knew were "in jeopardy." The shareholders list a representative selection of those bad loans which, in their view, Wells Fargo should have recognized by adjusting its reserves accordingly. Alleged problem loans, of which Wells Fargo was "on notice" prior to the start of the Class Period and failed properly to disclose, include loans extended to Revco D.S., Insilco Corp., Charter Medical Corp., R.H. Macy & Co., Campeau Corp., Jim Walters Corp., Gaylord Container Corp., West Point Pepperell, Inc., and NWA, Inc. The shareholders allege that Wells Fargo's non-performing assets and its reserves for possible loan losses were understated by at least $400 million and $350 million respectively, due to defaults on and the doubtful collectability of a number of its loans.

Accurate information regarding a bank's specific, substantial loans, with respect to which the alleged understating of value totals nearly $400 million in this case, cannot be deemed non-material as a

matter of law. In *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 276-77 & n. 6 (3d Cir.), *cert. denied*, ___U.S. ___, 113 S.Ct. 365, 121 L.Ed.2d 278 (1992), plaintiffs alleged that UJB Corp. fraudulently inflated its "earnings, assets, and net worth" by understating "its non-performing loans" and by failing "to provide adequate loan loss reserves for problem loans promptly and properly." The plaintiffs further alleged that UJB issued a series of statements which "misrepresented the true status of the company's loan loss reserves, financial health, lending practices, and internal controls." *Id.* at 280.[4] The court stated:

> There is nothing unique about representations and omissions regarding loan loss reserves that removes them from the purview of the antifraud provisions of the federal securities laws. In our view a reasonable investor would be influenced significantly by knowledge that a bank has knowingly or recklessly hidden its true financial status by deliberately misstating its level of non-performing loans, failing to provide adequate reserves, and indulging its problem loan customers.

Id. at 281.

Wells Fargo initially asserts that "an increase in the loan loss reserve, without more, does not warrant an inference of fraud," and "that an increase in the loan loss reserve from one quarter to the next does not alone imply that earlier estimates of the reserve were fraudulently understated." Yet, the shareholders' allegations do aver "something more": the deliberate failure to disclose the status of certain specific loans extended to identified borrowers. Wells Fargo responds that the Amended Complaint is deficient because it does not state how much the nine named corporations borrowed; when the loans were made; whether these loans were in default and, if so, when the default occurred; or whether reserves should have been established (but were not), and, if so, when and on what basis. However, this level of specificity is not required at the pleading stage. *See Moore v. Kayport Package Express, Inc.*, 885 F.2d 531, 540 (9th Cir. 1989) ("A pleading is sufficient under rule 9(b) if it identifies the circumstances

---

4. *See* Part III-B *infra*.

constituting fraud so that a defendant can prepare an adequate answer from the allegations.").

Wells Fargo's principal contention is that the shareholders' allegations amount to non-actionable mismanagement, not actionable securities fraud. It relies on *Santa Fe Indus. v. Green*, 430 U.S. 462, 97 S.Ct. 1292, 51 L.Ed.2d 480 (1977), in which the Court held that "Congress by § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement." *Id.* at 479, 97 S.Ct. at 1304. Characterizing the shareholders' Amended Complaint as one which challenges the timing of Wells Fargo's disclosure or some other "material deficiency in the administration of the loan loss reserve," Wells Fargo emphasizes that the calculation of reserves is an uncertain, "dynamic" process, and necessarily is based in large part on the judgment and discretion of corporate management. While the setting of loan loss reserves is, by all accounts, an "art and not a science," we do not believe that the broad corporate management exclusion from § 10(b) and Rule 10b-5, set forth in *Santa Fe*, is implicated when plaintiffs allege specific misrepresentations or material nondisclosures in violation of the federal securities laws. *See Virginia Bankshares, Inc. v. Sandberg*, ___ U.S. ___, ___ n. 6, 111 S.Ct. 2749, 2758 n. 6, 115 L.Ed.2d 929 (1991) ("Although a corporate transaction's 'fairness' is not, as such, a federal concern," a corporation's published claim of fairness 'presupposes a factual integrity that federal law is expressly concerned to preserve"); *Hayes v. Gross*, 982 F.2d 104, 106 (3d Cir. 1992) ("[A]n allegation of mismanagement on the part of a defendant will not alone support a claim under § 10(b) or Rule 10b-5; nor will an allegation that a defendant failed to disclose the existence of mismanagement. ... [H]owever, ... a complaint does allege an actionable misrepresentation if it alleges that a defendant was aware that mismanagement had occurred and made a material public statement about the state of corporate affairs inconsistent with the existence of the mismanagement."). That Wells Fargo's loan reserves were inadequate throughout the relevant period is not in serious dispute; "rather, the question [is] whether the inadequacy was in some sense culpable because the contingencies which proved them inadequate were foreseen or foreseeable." *Blackie v. Barrack*, 524 F.2d 891, 904 (9th Cir. 1975), *cert. denied*, 429 U.S. 816,

97 S.Ct. 57, 50 L.Ed.2d 75 (1976); *see also Urbach v. Sayles*, 779 F. Supp. 351, 354-55 (D.N.J. 1991) ("Although a manager may never 'know' with absolute certainty that a reserve against anticipated losses is inadequate, there will be circumstances where she 'knows,' based on any plausible and acceptable means of calculation, projection, or forecast, that reserves must be increased and yet represents that they need not be."). The shareholders allege that Wells Fargo knew of certain "contingencies" which rendered its loan reserves "inadequate," and failed to disclose this information to purchasers of its stock.

Therefore, taking the allegations of the Amended Complaint to be true, as the court must on a Rule 12(b)(6) motion, this is neither a case second-guessing decisions by management nor one alleging "fraud by hindsight"; rather, the shareholders have specifically identified facts omitted by Wells Fargo, which if subsequently determined to be material, and issued by Wells Fargo with the requisite scienter, will establish a violation of § 10(b) and Rule 10b-5. The cases upon which Wells Fargo places most weight do not dictate a different result, because unlike the present situation, the plaintiff in each of the cited decisions failed to point to alleged facts suggesting that the defendant's failure to disclose its "financial deterioration[ ]" was "attributable to fraud." *DiLeo v. Ernst & Young*, 901 F.2d 624, 626-27 (7th Cir.) (complaint did not "give examples of problem loans that [the accounting firm] should have caught, or explain how it did or should have recognized that the provisions for reserves established by [the bank's] loan officers were inaccurate"), *cert. denied*, 498 U.S. 941, 111 S.Ct. 347, 112 L.Ed.2d 312 (1990); *see also Christidis v. First Pennsylvania Mortgage Trust*, 717 F.2d 96, 100 (3d Cir. 1983) (complaint's "defect [was] the complete absence of any disclosure of the manner in which, in establishing reserves for bad debts in the financial statements relied upon, the defendants knowingly departed from reasonable accounting practices"); *Denny v. Barber*, 576 F.2d 465, 469 (2d Cir. 1978) (complaint failed to specify "what loans, at what times, and in what amounts were 'risky,'" or which items in defendant's annual report were knowingly false). Here, the shareholders' allegations successfully "distinguish their situation from that of many other[ ] [investors] who are adversely affected by business reverses." *DiLeo*, 901 F.2d at 627.

B

The shareholders contend that, in addition to sending a misleading message to the market in its financial reports, Wells Fargo "made affirmative representations inconsistent with the state of corporate affairs they knew to exist." *Hayes*, 982 F.2d at 106. The shareholders allege that Wells Fargo falsely portrayed itself as a successful company with favorable future prospects for growth and profit, concealed that many of Wells Fargo's highly leveraged transaction ("HLT") and real estate loans were high-risk in character and near default, and failed to disclose Wells Fargo's non-compliance with banking and accounting regulations governing the treatment of such problem loans. The shareholders allege that Wells Fargo knew or should have known that its various statements, while often literally accurate, "contributed to an overall misleading impression of the financial condition and business prospects of Wells Fargo."[5]

For example, the shareholders allege that Wells Fargo's 1990 Annual Report falsely "reassured the investing public":

> The year 1990 was marked by the threat of war in the Persian Gulf, a faltering economy and a continuous stream of bad news affecting the nation's financial services industry.
>
> In these unsettled times, investor concerns about what lay ahead for Wells Fargo and the California economy largely overshadowed the Company's steady financial performance.
>
> Net income for the year rose 18%, to $711.5 million. Earnings per common share were $13.39, an increase of 22% in comparison with last year's $11.02 per share.
>
> * * * * * *

---

5. Wells Fargo argues that these quotations are incomplete and are "wrenched out of context or edited in ways that change meaning." We disagree. Several of the shareholders' claimed misstatements identified by Wells Fargo are taken from the Appellants' Opening Brief, not the Amended Complaint. Other examples of "selective quotation" offered by Wells Fargo, while certainly presenting information in a manner favorable to the shareholders, are neither misleading nor unfair.

Defensive actions — redoubling surveillance of our real estate and corporate loan portfolios, working out arrangements with delinquent borrowers, trimming back corporate and real estate banking activities, increasing loan loss reserves, and strengthening the Company's capital base — occupied an increasingly important place in our day-to-day agendas.

* * * * * *

With the bulk of its loans and practically all of its deposits concentrated in California, Wells Fargo Bank has been a major contributor to — and beneficiary of — the state's economic growth.

* * * * * *

In short, we remain optimistic about California's prospects — and we still believe that our sharply focused regional marketing strategy is right for Wells Fargo. Over the years Wells Fargo has adopted a number of lending practices, pricing policies and credit standards designed to compensate for, and partly offset, the risks inherent in banking real estate and corporate credits. These practices have worked well for us in the past, and we believe they are especially appropriate to today's relatively high-risk banking environment.

* * * * * *

But in the final analysis, whatever success we've had in corporate and real estate lending is due to two things: good customers and a well-seasoned team of senior lending officers.

* * * * * *

Among other things, experience has taught us to anticipate and react quickly to potential problems — and to recognize small problems before they become big ones. It has also taught us to place as much faith in our analysis of our borrowers' integrity and their ability to pay as in the value of their collateral.

With respect to HLT loans, Wells Fargo's 1990 Annual Report stated:

> During the 1980s, Wells Fargo's Corporate Banking Group assisted in financing the restructuring, acquisition or buyout of slightly more than one hundred American corporations. Typically, Wells Fargo acted as lead banker and senior lender in these highly leveraged transactions (HLTs), providing secured term loans with average maturities of five to seven years. Normally, repayment schedules were based on reasonable projections of cash flow from operations, rather than the sale of corporate assets.
>
> * * * * * *
>
> The risks related to our HLT portfolio differ in two significant respects from those involved in real estate lending. First, the HLT portfolio is widely diversified, both geographically and by industry. Second, our experience in this type of lending has not been tested by recession. These differences make it more difficult to anticipate how the HLTs as a group will perform over the next 12 months. All we can say with certainty is that we will be exercising even more than our customary diligence in managing our HLTs as well as all other segments of our loan portfolio in coming months.
>
> * * * * * *
>
> The Company believes at the present time that these loans are substantially secured by the assets of the borrowers. In addition, at December 31, 1990 and 1989, senior HLT loans past due 90 days and still accruing were $8 million and $209 million, respectively. There were no HLT loans on restructured status and there was no ORE resulting from HLT loans at December 31, 1990 and 1989. Senior HLT loans of $36 million and $30 million were charged off in 1990 and 1989, respectively. During an economic downturn or a sustained period of rising interest rates, HLT borrowers may experience a decrease in their financial performance greater than that of non-HLT borrowers.

The shareholders allege that with respect to non-HLT loans, Wells Fargo "supplied numerous charts and tables, none of which warned the investing public of the full extent of the risks inherent there." The shareholders allege that Wells Fargo stated:

> The Company's determination of the level of the allowance, and correspondingly, the provision for loan losses

> rests upon various judgments and assumptions including, but not limited to, general economic conditions, loan portfolio composition and prior loan loss experience. The Company considers the allowance for loan losses of $885.4 million adequate to cover losses inherent in loans; commercial, real estate and other loan commitments; and standby letters of credit as of December 31, 1990.

Further, the shareholders allege that in subsequent SEC filings and financial statements, Wells Fargo falsely represented that its reported data "included all adjustments and provisions necessary for fair presentation of its results in conformity with Generally Accepted Accounting Principles ('GAAP')," Regulatory Accounting Principles ("RAP"), and various banking regulations. Finally, the shareholders allege that in a June 1991 article in *Barrons'* financial weekly, Wells Fargo dismissed the claim that the Bank would face an increase in non-performing real estate loans for the second quarter of 1991, and in response to media inquiries following a drop in the trading price of Wells Fargo stock on June 24, 1991, Wells Fargo stated that "it knew of no reason to explain" the drop in its stock price.

Where a defendant affirmatively characterizes management practices as "adequate" or loans as "substantially secured," "a defendant declares the subject of its representation to be material to the reasonable shareholder, and thus is bound to speak truthfully." *Shapiro*, 964 F.2d at 282. Statements of reasons, opinions, or beliefs are "factual" for purposes of the securities laws, and thus are actionable under § 10(b), if "one of three implied factual assertions is inaccurate: (1) that the statement is genuinely believed, (2) that there is a reasonable basis for that belief, and (3) that the speaker is not aware of any undisclosed facts tending to seriously undermine the accuracy of the statement." *Hanon v. Dataproducts Corp.*, 976 F.2d 497, 501 (9th Cir. 1992) (quotation marks and citation omitted); *see also Mayer v. Mylod*, 988 F.2d 635, 639 (6th Cir. 1993).

At least two of the Wells Fargo statements upon which the shareholders rely may be opinions of the sort classified as "factual" for purposes of § 10(b): "[t]he Company believes at the present time that these [HLT] loans are substantially secured by the assets of the borrowers" and "[t]he Company considers the allowance for loan losses

of $885.4 million adequate." Because we believe at least these two statements cannot be dismissed as non-actionable as a matter of law, we do not examine in detail each of the other allegations that the shareholders make. We do note, however, that the vast majority of the "deceptive" statements catalogued in the shareholders' Amended Complaint are not alleged to be factually inaccurate and pertain to Wells Fargo's past performance. These are clearly not materially misleading. *See In re Convergent Technologies Sec. Litig.*, 948 F.2d 507, 513 (9th Cir. 1991) ("The challenged statements do not imply any comparison between the rate of past and future growth. They simply report past performance and assert specific limited predictions for the future."). Whether other statements by Wells Fargo are actionable, such as allegations that Wells Fargo failed to comply with various accounting rules and banking regulations governing classification of loans and public disclosure, depends on whether the shareholders can make out the existence of an underlying material misstatement or omission of which Wells Fargo had knowledge. We leave further analysis to the district court.

The shareholders have specifically identified Wells Fargo's allegedly misleading statements and, as discussed in Part III-A, allege that these statements were not believed by Wells Fargo when published, lacked any reasonable basis, and were made despite known, undisclosed facts tending seriously to undermine their accuracy. Accordingly, the shareholders have stated a claim under § 10(b) and Rule 10b-5. While it may well turn out, as Wells Fargo maintains, that the contested statements are neither material nor misleading when considered in context, that is a determination better made on the kind of record which a motion for summary judgment affords.[6]

---

6. The shareholders also argue that their allegation that Wells Fargo failed to comply with the mandate of SEC Regulation S-K, Item 303 states an actionable securities fraud claim under §10(b). *See* 17 C.F.R. § 229.303(a)(3)(ii). Acknowledging that Regulation S-K does not provide an independent cause of action, the shareholders contend that an SEC filing which does not comply with Item 303 creates a "false and misleading impression," and thus is highly relevant for purposes of determining whether a violation of § 10(b) and Rule 10b-5 has occurred. We do not reach this point in light of our disposition of their claims under Rule 10b-5.

IV

Wells Fargo argues that the shareholders have failed to allege facts which provide a basis for the inference of scienter.[7] Contrary to Wells Fargo's assertion, the shareholders allege facts to show that Wells Fargo knew or recklessly ignored that its challenged statements were materially misleading, and that the Wells Fargo defendants "stood to receive more compensation because of the alleged non-disclosure of material information." While "allegation[s] of unusual insider trading by defendants immediately preceding the disclosure of negative news" may be, as Wells Fargo contends, a characteristic of a "typical securities fraud class action," they are not required. The allegations of motive and opportunity in the complaint are sufficient to establish a basis for inferring Wells Fargo's fraudulent intent. *Cf. Blake v. Dierdorff*, 856 F.2d 1365, 1369-70 (9th Cir. 1988) (allegations that corporate management distributed false and misleading information to protect their executive positions and substantial compensation, and to increase bonus compensation pled specific intent to commit mail fraud with the requisite particularity). The cases relied upon by Wells Fargo do not support its argument, as they involve appeals from either summary judgment or dismissals of complaints which were substantially more general and conclusory than the shareholders' in the present case. *See e.g. Apple Computer*, 886 F.2d at 1117 (no genuine issue of material fact as to scienter where plaintiffs produced no evidence controverting defendants' affidavits stating that contested statements were made in good faith); *California Architectural Bldg. Prods., Inc. v. Franciscan Ceramics, Inc.*, 818 F.2d 1466, 1469-72 (9th Cir. 1987) (summary judgment record contains no evidence that defendants had the requisite intent to defraud, nor did plaintiffs' claim make economic sense), *cert. denied*, 484 U.S. 1006, 108 S.Ct. 698, 699, 98 L.Ed.2d 650 (1988); *Vaughn v. Teledyne, Inc.*, 628 F.2d 1214, 1220 (9th Cir. 1980) (plaintiffs present no probative evidence relevant to the issue of intent to defraud); *see also Wexner v. First Manhattan Co.*, 902 F.2d 169, 172-73 (2d Cir. 1990) (affirming dismissal of complaint where plaintiffs failed to allege general details of securities

---

7. Wells Fargo's claim that the shareholders failed sufficiently to plead scienter was not addressed directly by the district court.

fraud conspiracy, how defendants knew contested statements to be false, roles of individual defendants, or how defendants stood to gain as a result); *Connecticut Nat'l Bank v. Fluor Corp.*, 808 F.2d 957, 961-62 (2d Cir. 1987) (according to facts pled, no plausible economic incentive for defendants to deceive shareholders).

V

The shareholders read the district court's Order Granting Defendants' Motion to Dismiss as holding that the shareholders failed to meet the "in connection with" requirement of a § 10(b) claim — *i.e.*, that Wells Fargo's alleged fraud was employed "in connection with" the purchase or sale of securities. While the shareholders' interpretation is reasonable based on certain language in the district court's order (*e.g.*, the "fraud alleged must 'touch' upon securities transactions") and the court's citation to *SEC v. Clark*, 915 F.2d 439, 449 (9th Cir. 1990), we need not decide this issue as Wells Fargo effectively concedes that the "in connection with" requirement was met.

VI

We conclude that the shareholders have stated a claim under section 10(b) of the '34 Act and Rule 10b-5. Accordingly, we reverse the district court's order dismissing the shareholders' Amended Complaint.

REVERSED.

TROTT, Circuit Judge, dissenting.

I respectfully dissent, and I do so essentially because I believe our colleague on the district court had it right when he dismissed this complaint for failure to state a claim. I can do no better than repeat the essence of his analysis:

> In order to survive a motion to dismiss, plaintiffs who allege securities fraud must plead facts which, if true, con-

stitute fraud. Fed.R.Civ.Proc. 9(b). Plaintiffs are not required to assert facts pertaining to fraud that are "peculiarly within the opposing party's knowledge," but the requirements of Rule 9(b) are satisfied only if the allegations of fraud are accompanied by a statement of the facts upon which the fraud is founded. *Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1439 (9th Cir. 1987) (citations omitted).

Furthermore, plaintiffs' facts, and the inferences which reasonably can be drawn from them, must support a claim of fraud in the purchase or sale of securities. The federal securities laws do not proscribe all fraud which occurs in the business world. The fraud alleged must "touch" upon securities transactions. *S.E.C. v. Clark*, 915 F.2d 439, 449 (9th Cir. 1990).

Nothing in plaintiffs' voluminous complaint states facts which support a coherent theory of securities fraud. Plaintiff's (sic) theory begins with heightened federal regulatory guidelines, issued in January, March and May of 1991, which suggested (but did not require) changes in the methods banks use to value nonaccrual loans and highly leveraged transactions. Plaintiffs then describe what they allege to be a three month long "scheme" by the defendants to misrepresent the Bank's financial health through understated loan loss provisions for the first quarter of 1991. Despite a complaint of 59 pages, containing 134 paragraphs of allegations, plaintiffs' counsel was unable to point to one paragraph or set of paragraphs which provide the facts necessary to infer fraud in the purchase of (sic) sale of securities.

Indeed, the facts in the complaint, which may suggest mismanagement on the part of the Bank, and might even suggest a violation of banking regulations, cannot be fairly read to raise an inference that the alleged misconduct by the defendants touched upon a securities transaction. The fact that defendants increased loan loss reserves in the second quarter, and at all times relevant accurately reported the amount of actual reserves set aside by the bank, does not by itself allege securities fraud, notwithstanding conclusory statements of fraud in the complaint.

Judge Friendly, in adjudicating a securities fraud claim from an earlier period of financial reversals in the banking industry, characterized a complaint similar to the one filed in this matter as "an example of alleging fraud by

> hindsight." *Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978). Judge Friendly recognized the difficulties encountered by a small shareholder in framing a securities fraud complaint against a large corporation, and the consequent need to relax pleading requirements, but dismissed the complaint in *Denny* because "there still must be more than vague allegations that, as shown by subsequent developments, the corporation's true financial picture was not so bright in some respects as its annual reports had painted and that the defendants knew, or were reckless in failing to know, this." *Id.*
>
> In the argot of today, a complaint should be dismissed if, read as a whole, it creates a strong impression that, on a report of bad news from the defendant, "plaintiffs' counsel simply stepped to the nearest computer console, conducted a global Nexis search, pressed the 'Print' button, and filed the product as their complaint." *Hershfang v. Citicorp*, 767 F.Supp. 1251 (S.D.N.Y. 1991). Here, plaintiffs cite annual reports, quarterly reports, banking regulations and newspaper articles. They list customers of the Bank who are known today to be burdened with debt. But nowhere does the complaint link the facts stated to a coherent theory of securities fraud.

Fraud on the market is a problematic theory. Unless carefully managed by us, it threatens to wrack our economy. Anytime a stock price drops significantly, will all prior rosy statements by management concerning the company's financial condition and future business prospects become the basis for actionable fraud?

I note with great interest that the supposedly defrauded stockholders in this case state in their complaint that "the trading price of Wells Fargo's common stock, upon disclosure [of the "fraud"] ... collapse[d] ... from over $97 per share to $74 per share." I note with equally great interest that the trading price of this stock on the day of oral argument, May 10, 1993, was $104.75. This is an interesting kind of fraud where the value of the disputed stock before the case goes to trial exceeds its value before the alleged wrongdoing that caused it to "collapse." I would suspect that on remand the district court will be confronted with an interesting motion for summary judgment.

When businesses complain about the costs heaped on them by a court system with no adequate controls, I believe they will be able to point to this litigation as an example.

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

In re: WELLS FARGO SECURITIES LITIGATION	**Master File No. NC-91-1944-VRW**
This Document Relates To: ALL ACTIONS.	**ORDER GRANTING DEFENDANTS' MOTION TO DISMISS**

[Filed December 21, 1991]

This matter came before the court on Thursday, December 5, 1991 on plaintiffs' motion for class certification and defendants' motion to dismiss the complaint for failure to state a claim upon which relief can be granted. Counsel for the parties had previously appeared before the court on Friday, November 1, 1991 on related motions. The court has considered the arguments of counsel, and the briefs, declarations and other documents filed in connection with this matter.

Plaintiffs' amended class action complaint purports to state federal claims under §§ 10(b) and 20 of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder. Plaintiffs also assert claims under state law for fraud and negligent misrepresentation. The gravamen of plaintiffs' complaint is that Wells Fargo's banking subsidiary, Wells Fargo Bank ("the Bank"), defrauded investors by misstating the amount of loan loss reserves necessary to protect the Bank from default on high risk loans. Plaintiffs' allege that this activity began on March 5, 1991, when the Bank published in its annual report that it was, in accordance with recently-promulgated banking regulations, carefully monitoring its portfolio of high-risk loans. The alleged fraud continued through April 16, 1991, when the Bank reported first quarter loan loss reserves of $85 million. The fraud was

disclosed, according to plaintiffs, when the Bank announced on June 25, 1991 that it would increase loan loss reserves by $350 million in the second quarter.

Defendants' motion to dismiss is governed by Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure. In ruling on a motion to dismiss, district courts must accept all material allegations of fact alleged in the complaint as true, and resolve all doubts in favor of the plaintiff. *Blake v. Dierdorff*, 856 F.2d 1365, 1368 (9th Cir. 1988). A complaint may be dismissed as a matter of law for two reasons: (1) lack of a cognizable legal theory, or (2) insufficient facts under a cognizable theory. *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 533-34 (9th Cir. 1984) (citing 2A J. Moore, Moore's Federal Practice, ¶ 12.08 at 2271 (2d ed. 1982)).

In order to survive a motion to dismiss, plaintiffs who allege securities fraud must plead facts which, if true, constitute fraud. Fed. R. Civ. Proc. 9(b). Plaintiffs are not required to assert facts pertaining to fraud that are "peculiarly within the opposing party's knowledge," but the requirements of Rule 9(b) are satisfied only if the allegations of fraud are accompanied by a statement of the facts upon which the fraud is founded. *Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1439 (9th Cir. 1987) (citations omitted).

Furthermore, plaintiffs' facts, and the inferences which reasonably can be drawn from them, must support a claim of fraud in the purchase or sale of securities. The federal securities laws do not proscribe all fraud which occurs in the business world. The fraud alleged must "touch" upon securities transactions. *S.E.C. v. Clark*, 915 F.2d 439, 449 (9th Cir. 1990).

Nothing in plaintiffs' voluminous complaint states facts which support a coherent theory of securities fraud. Plaintiff's [sic] theory begins with heightened federal regulatory guidelines, issued in January, March and May of 1991, which suggested (but did not require) changes in the methods banks use to value nonaccrual loans and highly leveraged transactions. Plaintiffs then describe what they allege to be a three month long "scheme" by the defendants to misrep-

resent the Bank's financial health through understated loan loss provisions for the first quarter of 1991. Despite a complaint of 59 pages, containing 134 paragraphs of allegations, plaintiffs' counsel was unable to point to one paragraph or set of paragraphs which provide the facts necessary to infer fraud in the purchase of [sic] sale of securities.

Indeed, the facts in the complaint, which may suggest mismanagement on the part of the Bank, and might even suggest a violation of banking regulations, cannot be fairly read to raise an inference that the alleged misconduct by the defendants touched upon a securities transaction. The fact that defendants increased loan loss reserves in the second quarter, and at all times relevant accurately reported the amount of actual reserves set aside by the bank, does not by itself allege securities fraud, notwithstanding conclusory statements of fraud in the complaint.

Judge Friendly, in adjudicating a securities fraud claim from an earlier period of financial reversals in the banking industry, characterized a complaint similar to the one filed in this matter as "an example of alleging fraud by hindsight." *Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978). Judge Friendly recognized the difficulties encountered by a small shareholder in framing a securities fraud complaint against a large corporation, and the consequent need to relax pleading requirements, but dismissed the complaint in *Denny* because "there still must be more than vague allegations that, as shown by subsequent developments, the corporation's true financial picture was not so bright in some respects as its annual reports had painted and that the defendants knew, or were reckless in failing to know, this." *Id.*

In the argot of today, a complaint should be dismissed if, read as a whole, it creates a strong impression that, on a report of bad news from the defendant, "plaintiffs' counsel simply stepped to the nearest computer console, conducted a global Nexis search, pressed the 'Print' button, and filed the product as their complaint." *Hershfang v. Citicorp*, 767 F. Supp. 1251 (S.D.N.Y. 1991). Here, plaintiffs cite annual reports, quarterly reports, banking regulations and newspaper

articles. They list customers of the Bank who are known today to be burdened with debt. But nowhere does the complaint link the facts stated to a coherent theory of securities fraud.

Plaintiffs' counsel cites nearly two dozen federal district court cases, from districts other than this one, in which courts have sustained complaints against financial institutions which allegedly pled facts similar to the complaint at issue here. Plaintiffs' Memorandum in Opposition to Defendants' Motion to Dismiss at 14, n. 9. Defendants' counsel counters with even more reported cases wherein "allegations such as those of the amended complaint" were found not to state a claim. Defendant's Memorandum in Support of Motion to Dismiss at 10-11, n. 7. Again, Judge Friendly's admonition is instructive: "We see no profit in attempting to analyze these decisions, which may or may not be consistent and each of which necessarily rests on its particular facts." *Denny*, 576 F.2d at 470. Similarly, the complaint at bar must stand or fall on its own terms, and in accord with well-established pleading requirements.

There can be no dispute that this complaint fails to state a claim under the federal securities laws. The question is whether to afford plaintiffs' counsel leave to try again. A dismissal without leave to amend is proper where "allegation of other facts consistent with the challenged pleading could not possibly cure the deficiency" in the complaint. *Albrecht v. Lund*, 845 F.2d 193, 195 (9th Cir. 1988). Plaintiffs hastily filed suit following the Bank's announcement of the increase in loan loss reserves. In fact, the first complaint in this matter was filed on the very day in which Wells Fargo made its announcement. The amended complaint, a collaborative effort by a dozen law firms with significant experience in field of securities litigation, was filed two months later. This complaint cannot be further improved. Additional litigation of this matter would only place an undue burden on the defendants and the shareholders of Wells Fargo. Accordingly, defendants' motion to dismiss the federal causes of action in the complaint is **GRANTED WITH PREJUDICE**.

Although federal courts have jurisdiction to hear state law claims which are supplemental to federal claims, a court may decline to ex-

ercise its supplemental jurisdiction over a claim if the court has dismissed all claims over which it has original jurisdiction. 28 U.S.C. § 1367(c)(3). Defendants' motion to dismiss the state law claims is **GRANTED WITH PREJUDICE**.

IT IS SO ORDERED.

DATED: December 20, 1991

/s/ VAUGHN R. WALKER
United States District Judge

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: WELLS FARGO SECURITIES LITIGATION

HOWARD GREENWALD; MILTON FRIEDMAN; SHELDON SHORE; JOHN PAUL DECKER; FAIRMOUNT FINANCIAL CORPORATION; ARTHUR-MAGNA INC; HAROLD BLOCH; ROBERT C. SCHILLING, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants

v.

WELLS FARGO & CO., a Delaware Corporation; CARL E. REICHARDT; PAUL HAZEN; ROBERT L. JOSS; CLYDE W. OSTLER; DAVID M. PETRONE; WILLIAM F. ZUENDT; STEPHEN A. ENNA; RODNEY L. JACOBS; PATRICK W. LEAHY; GUY ROUNSAVILLE, JR.,

Defendants-Appellees

No. 92-15344

D.C. No. CV-91-01944-VRW

ORDER

[Filed March 8, 1994]

Before: REINHARDT, TROTT and RYMER, Circuit Judges

The panel has voted to deny the petition for rehearing and to reject the suggestion for rehearing en banc.

The full court has been advised of the suggestion for en banc rehearing, and no judge of the court has requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35(b).

The petition for rehearing is DENIED and the suggestion for a rehearing en banc is REJECTED.

[Designation of counsel omitted]

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

HOWARD GREENWALD, MILTON FRIEDMAN, SHELDON SHORE, JOHN PAUL DECKER, FAIRMOUNT FINANCIAL CORPORATION, ARTHUR-MAGNA, INC., HAROLD BLOCH, and ROBERT C. SCHILLING, On Behalf of Themselves and All Others Similarly Situated,

Plaintiffs,

vs.

WELLS FARGO & CO., a Delaware Corporation, and CARL E. REICHARDT, PAUL HAZEN, ROBERT L. JOSS, CLYDE W. OSTLER, DAVID M. PETRONE, WILLIAM F. ZUENDT, STEPHEN A. ENNA, RODNEY L. JACOBS, PATRICK W. LEAHY, and GUY ROUNSAVILLE, JR., individuals,

Defendants.

No. C 91 1944 VRW

CLASS ACTION

NOTICE OF MOTION AND MOTION TO DISMISS THE AMENDED CLASS ACTION COMPLAINT

Date: November 1, 1991
Time: 10:30 A.M.
Courtroom of the Honorable Vaughn R. Walker, U.S.D.J.

[Filed September 30, 1991]

TO: ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that on November 1, 1991, at 10:30 A.M., or as soon thereafter as counsel may be heard, in the Courtroom of the Honorable Vaughn R. Walker, United States District Judge, 450 Golden Gate Avenue, San Francisco, California,

Wells Fargo & Co. and the individual defendants, by counsel, will and hereby do move this court, pursuant to Federal Rules of Civil Procedure 12(b)(6) and 9(b), for an order dismissing the Amended Class Action Complaint.

This motion is based on this Notice of Motion and Motion, the Memorandum in Support of Motion by Defendants to Dismiss Plaintiffs' Amended Complaint, the Declaration of Michael L. Zigler in Support of Defendants' Motion to Dismiss, and the [Proposed] Order Granting Defendants' Motion to Dismiss filed concurrently, on the pleadings and files in this action, and on such argument as may be presented at the hearing.

Dated: September 30, 1991

MELVIN R. GOLDMAN
JACK W. LONDEN
MICHAEL L. ZIGLER
WILLIAM N. GERSON
MORRISON & FOERSTER

By /s/ Michael L. Zigler
Attorneys for Wells Fargo & Co.
and the Individual Defendants

[Proof of Personal Service, Proof of Service By Mail, and Service List omitted]

[Designation of counsel omitted]

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

HOWARD GREENWALD, MILTON FRIEDMAN, SHELDON SHORE, JOHN PAUL DECKER, FAIRMOUNT FINANCIAL CORPORATION, ARTHUR-MAGNA, INC., HAROLD BLOCH, and ROBERT C. SCHILLING, On Behalf of Themselves and All Others Similarly Situated,

Plaintiffs,

vs.

WELLS FARGO & CO., a Delaware Corporation, and CARL E. REICHARDT, PAUL HAZEN, ROBERT L. JOSS, CLYDE W. OSTLER, DAVID M. PETRONE, WILLIAM F. ZUENDT, STEPHEN A. ENNA, RODNEY L. JACOBS, PATRICK W. LEAHY, and GUY ROUNSAVILLE, JR., individuals,

Defendants.

Civil No. C-91-1944-VRW

CLASS ACTION

AMENDED CLASS ACTION COMPLAINT FOR DAMAGES FOR VIOLATIONS OF THE FEDERAL SECURITIES LAWS; FRAUD AND NEGLIGENT MISREPRESENTATION

Plaintiffs Request A Trial By Jury

[Filed August 26, 1991]

All allegations made in this Complaint are based on information and belief, except those allegations that pertain to the named plaintiffs and their counsel, which are based on personal knowledge. Plaintiffs' information and belief is based, *inter alia*, on the investigation made by and through their attorneys.

INTRODUCTION AND OVERVIEW OF ACTION

1. This class action is filed on behalf of all purchasers of Wells Fargo & Company ("Wells Fargo" or the "Company") common stock, to remedy violations by Defendants during the period from March 5, 1991 through June 25, 1991 (the "Class Period"), of the federal securities laws and California statutory and common law doctrines.

2. This class action lawsuit arises out of the gross mismanagement of Wells Fargo by its officers and directors, which was accompanied by a pattern of deception accomplished through false and misleading statements issued by Defendants concerning Wells Fargo, its business, financial condition, results from operations, quality of its management and future business prospects to the securities markets between March 5, 1991 and June 25, 1991, which had the purpose and effect of artificially inflating the trading price of Wells Fargo's common stock, throughout that period and which, upon disclosure, ultimately resulted in the collapse of Wells Fargo common stock from over $97 per share to $74 per share. The officer and director Defendants' gross mismanagement also resulted in establishment of huge amounts of additional loan loss reserves in excess of $350 million, more than four times the loan loss reserves for the prior quarter, and actual loan losses in the second quarter of 1991 of $180 million, more than two and one-half times the loan losses reported in the prior quarter.

3. During the Class Period, Defendants disseminated or caused Defendant Wells Fargo to disseminate a series of materially false and misleading statements, failed to disclose material facts and failed to correct prior statements concerning the business and finances of Wells Fargo. At the time Wells Fargo was announcing the payment of shareholders' dividends, as well as continued growth and profitability, Defendants knew, or should have known, and failed to disclose to Plaintiffs and other purchasers of Wells Fargo stock, that the Company was experiencing losses due to its previously undisclosed investments in high-risk loans, and that banking regulators had issued a number of regulations and policy statements that would materially

impact Wells Fargo's income for 1991. In particular, disclosure of the financial impact of the long-standing and reckless lending practices of the Company's senior management in the late 1980's in connection with extremely risky highly-leveraged transactions ("HLT Loans") and extremely speculative real estate ventures caused the virtual collapse of the market prices of the common stock of Wells Fargo.

4. In March 1991, Wells Fargo officers and directors named as Defendants herein became aware that Wells Fargo was suffering large losses in its loan portfolio due, *inter alia*, to inadequate and reckless lending procedures and loan loss recognition policies which resulted in huge increases in non-performing assets in the face of already inadequate loan loss reserves, many of which were incurred in connection with Wells Fargo's HLT loans. These Defendants realized that if the true nature and extent of the losses that Wells Fargo had already suffered, as well as the full nature and extent of the losses it would suffer in the coming months, were revealed, Wells Fargo's stock price would collapse overnight, their gross mismanagement of the Bank would be exposed, its capital position would be gravely impaired and they would face, *inter alia*, the prospect of the loss of their executive positions, possible punitive regulatory actions and other adverse consequences. In order to avoid these untoward consequences for as long as possible and to attempt to cover up their misconduct and Wells Fargo's precarious financial condition, these Defendants commenced a scheme and conspired to deceive Wells Fargo's current shareholders and the financial marketplace with respect to the true nature of the losses already suffered by Wells Fargo and to be suffered in the foreseeable future by engaging in a common course of conduct and conspiracy to issue false and misleading statements, including false financial statements, concerning Wells Fargo. In furtherance of this scheme, on March 5, 1991, the Defendants misrepresented and understated the true nature of Wells Fargo's non-performing assets and loan loss problems in the 1990 Annual Report. Thereafter, Defendants continued their scheme by consistently understating the true amount of Wells Fargo's nonperforming loans and required loan loss reserves by hundreds of millions of dollars, by falsely representing that Wells Fargo directors would "be exercising *even more than our*

customary diligence in managing [Wells Fargo's] HLT, as well as other segments of [Wells Fargo's] loan portfolio in coming months." These foregoing representations lead [sic] analysts to estimate earnings per share for Wells Fargo common stock for 1991 and 1992 at $10.50 per share in each year. In addition to making these false and misleading statements, to further foster the false image of profitability, controlled growth, high-quality assets, effective lending controls and standards and competent management the Defendants were projecting, Defendants issued or caused Wells Fargo to issue materially false and misleading financial figures for the first quarter of fiscal 1991 by which Wells Fargo reported earnings per share of $2.86, well in excess of analysts expectations, due in large part to the grossly inadequate loan loss reserve provisions.

5. Finally, when the aforementioned material adverse facts were belatedly disclosed to the public, Wells Fargo common stock lost approximately one-third of its value, causing Plaintiffs and the Class millions of dollars in investment losses. In particular, the Company's common stock fell precipitously in value when Wells Fargo revealed that it would increase its loan loss reserves by $350 million (more than four times the $85 million, the amount the Company had previously set aside in the first quarter of 1991), and that total non-accrual loans had dramatically increased, all of which had previously been concealed from and not disclosed to the investing public, including Plaintiffs and the Class as defined here.

JURISDICTION AND VENUE

6. The Court has jurisdiction of the first cause of action pursuant to §27 of the Securities Exchange Act of 1934 (the "Exchange Act") (15 U.S.C. §78aa).

7. This Court has jurisdiction over the second and third claims for relief, which are so related to the federal claims that the claims form part of the same case or controversy under Article III of the United States Constitution, under principles of supplemental jurisdiction (28 U.S.C. §1367).

8. As more fully described herein, in connection with the acts alleged in this complaint, Defendants, directly or indirectly, continuously used the means and instrumentalities of United Sates [sic] interstate commerce throughout the Class Period, including the United States mails and interstate telephone and wire communications and the facilities of the United States national securities markets.

9. Plaintiffs bring this suit as a class action pursuant to §§10(b) and 20 of the Exchange Act (15 U.S.C. §§78j(b)) and 78t and Rule 10b-5 promulgated thereunder (17 C.F.R. §240.10b-5).

10. Venue is proper in this District pursuant to §27 of the Exchange [sic] and 28 U.S.C. §1391(b). A substantial portion of the events and conduct giving rights [sic] to the violations of law complained of here, including the sales of securities in preparation and dissemination to the investing public of false and misleading information, incurred, and emanated from, this District. In addition, the principal place of business of Wells Fargo is within this District and most or all of the Individual Defendants performed their duties as officers and directors of these entities within this District. In connection with the acts, conduct and other wrongs complained of here, Defendants directly and indirectly, used the means and instrumentalities of interstate commerce, including the United States mails and interstate telephone communications.

THE PARTIES

11. Plaintiff Howard Greenwald purchased 100 shares of Wells Fargo common stock on May 25, 1991 at a price of $95.22 per share in reliance on the integrity of the market and at prices inflated by defendants' misconduct during the Class Period and has been damaged thereby. Plaintiff Greenwald still maintains his interest in Wells Fargo common stock, which as a result of the material adverse facts described here, has plummeted in value.

12. Plaintiff Milton Friedman purchased 300 shares of Wells Fargo common stock on June 14, 1991 at the price of $90.70 per share

in reliance on the integrity of the market and at prices inflated by defendants' misconduct during the Class Period and has been damaged thereby. Plaintiff Friedman still maintains his interest in Wells Fargo common stock, which as a result of the material adverse facts described here, has plummeted in value.

13. Plaintiff Sheldon Shore purchased 100 shares of Wells Fargo common stock on June 24, 1991 at a price of $81.50 per share in reliance on the integrity of the market and at prices inflated by defendants' misconduct during the Class Period and has been damaged thereby.

14. Plaintiff Fairmount Financial Corporation purchased shares of Wells Fargo common stock during the Class Period in reliance on the integrity of the market and at prices inflated by defendants' misconduct during the Class Period and has been damaged thereby.

15. Plaintiff John Decker purchased shares of Wells Fargo common stock during the Class Period in reliance on the integrity of the market and at prices inflated by defendants' misconduct during the Class Period and has been damaged thereby.

16. Plaintiff Arthur-Magna, Inc. purchased shares of Wells Fargo common stock during the Class Period in reliance on the integrity of the market and at prices inflated by defendants' misconduct during the Class Period and has been damaged thereby.

17. Plaintiff Harold Bloch purchased 1000 shares of Wells Fargo common stock on May 14, 1991 in reliance on the integrity of the market and at prices inflated by defendants' misconduct during the Class Period and has been damaged thereby.

18. Plaintiff Robert C. Schilling purchased shares of Wells Fargo common stock during the Class Period in reliance on the integrity of the market and at prices inflated by defendants' misconduct during the Class Period and has been damaged thereby.

19. Defendant Wells Fargo is a Delaware corporation, with its principal place of business in this District. Wells Fargo is a bank holding company with subsidiaries engaged in commercial banking, investment advisory services and agricultural consumer financing.

20. Wells Fargo's business has been owning and controlling banks and bank-related affiliates. Wells Fargo common stock is registered with the Securities & Exchange Commission ("SEC") pursuant to § 12(g) of Exchange Act and its common stock is listed and actively traded through NASDAQ and on the New York and Pacific stock exchanges in an open and efficient market. As of April 30, 1991, Wells Fargo had 51,660,987 shares of common stock outstanding held by more than 31,554 owners of record.

21. Defendant Carl E. Reichardt ("Reichardt") is chairman of the Board of Directors and Chief Executive Officer of Wells Fargo. For 1990, Defendant Reichardt received total cash and other compensation from Wells Fargo valued at more than $1,468,333 including substantial amounts in incentive-based compensation paid by Wells Fargo. For the years 1988, 1989 and 1990, Defendant Reichardt has received incentive based cash bonuses from Wells Fargo of at least $2,225,000. Defendant Reichardt was the beneficial owner of 392,362 shares of Wells Fargo common stock as of December 31, 1990. Defendant Reichardt is chairman of Wells Fargo's Executive Committee, which is authorized to supervise the general management and direction of the business affairs of Wells Fargo, and is a member of Wells Fargo Bank's Trust Committee which supervises the administration and proper exercise of the fiduciary powers of Wells Fargo Bank. As a result of his position, Defendant Reichardt had the ultimate responsibility for supplying data and determining final presentation of statements made to the investment community in the form of press releases and public filing by Wells Fargo, as well as the ultimate determination and review of Wells Fargo's loan portfolio, including assuring that proper financial controls were followed, that collateral was properly valued, and that such risks were properly assessed and reflected in the Company's financial statements.

22. Defendant Paul Hazen ("Hazen") is President and Chief Operating Officer of Wells Fargo. Hazen is a member of the Board of Directors of the Company. For 1990, Defendant Hazen received total cash and other compensation from Wells Fargo of at least $1,081,667. For the years 1988, 1989 and 1990, Defendant Hazen has received incentive based cash bonuses from Wells Fargo of at least $1,640,000. Defendant Hazen was the beneficial owner of 290,378 shares of Wells Fargo's common stock as of December 31, 1990. Defendant Hazen is a member of Wells Fargo's Executive Committee, and is chairman of Wells Fargo Bank's Trust Committee. As a result of his positions, Defendant Hazen had responsibility for the ultimate determination of and review of the loan portfolio of Wells Fargo including assuring that proper financial controls were followed, that collateral was properly valued, and that credit risks were properly assessed and reflected on Wells Fargo's financial statements.

23. Defendant Robert L. Joss ("Joss") is vice-chairman of Wells Fargo. For 1990, Defendant Joss received total cash and other compensation from Wells Fargo of at least $750,000. For the years 1988, 1989 and 1990, Defendant Joss has received incentive based cash bonuses from Wells Fargo of at least $1,015,000.

24. Defendant David M. Petrone ("Petrone") is vice-chairman of Wells Fargo. For 1990, Defendant Petrone received total cash and other compensation from Wells Fargo of at least $703,333. For the years 1988, 1989 and 1990, Defendant Petrone received incentive based cash bonuses from Wells Fargo of at least $965,000.

25. Defendant William F. Zuendt ("Zuendt") is vice-chairman of Wells Fargo. For the year 1990, Defendant Zuendt received total cash and other compensation from Wells Fargo of at least $753,333. For the years 1988, 1989 and 1990, Defendant Zuendt received incentive based cash bonuses from Wells Fargo of at least $1,045,000.

26. Defendant Clyde W. Ostler ("Ostler") is vice-chairman of Wells Fargo.

27. Defendant Stephen A. Enna ("Enna") is executive vice-president of Wells Fargo.

28. Defendant Rodney L. Jacobs ("Jacobs") is executive vice-president and chief financial officer of Wells Fargo.

29. Defendant Patrick W. Leahy ("Leahy") is executive vice-president of Wells Fargo.

30. Defendant Guy Rounsaville, Jr. ("Rounsaville") is executive vice-president, and chief counsel and secretary of Wells Fargo.

31. Defendants Reichardt, Hazen, Joss, Ostler, Petrone, Zuendt, Enna, Jacobs, Leahy and Rounsaville, shall be collectively referred to as the "Individual Defendants."

32. Each of the Individual Defendants is an executive of Wells Fargo and was therefore entitled to participate in one or more of the following Wells Fargo benefit plans:

(a) Wells Fargo's Incentive Pay Plan, under which all executives of Wells Fargo as a group received at least $6,731,332 in 1990;

(b) Wells Fargo's Tax Advantage Retirement under which all of the executives of Wells Fargo as a group received at least $416,126 in 1990;

(c) Wells Fargo's Employee Stock Purchase Plan;

(d) Wells Fargo's Executive Life Plan, which pays lump-sum benefits upon the death of a participant;

(e) Wells Fargo Executive Loan Plan, which entitles Wells Fargo executives to receive general purpose or mortgage loans at favorable interest rates, which in February of 1991 was as low as 6.96%, the balance of these loans as of December 31, 1990 was $4,708,879; and

(f) Wells Fargo's Equity Interest Plan, which grants certain executives options or restricted share rights which may be converted into Wells Fargo common stock, under which all of the executives of Wells Fargo as a group received options to purchase 349,000 shares of Wells Fargo stock, the net value of which was $5,124,793, as defined by market value less exercise price.

33. To properly discharge their duties and obligations, the Individual Defendants, and each of them, were required to exercise prudent supervision over the management and financial affairs of Wells Fargo. By virtue of this obligation, the Individual Defendants were required, among other things:

(a) To manage, conduct, supervise and direct the business and affairs of Wells Fargo in accordance with state and federal laws;

(b) To exercise reasonable control and supervision over the officers and employees of Wells Fargo;

(c) To exercise reasonable care in evaluation of the prudence and soundness of policies and practices proposed to be undertaken by Wells Fargo;

(d) To ensure that Wells Fargo did not engage in unsafe, imprudent or unsound practices and that Wells Fargo complied with all federal and state laws and regulations;

(e) To establish guidelines and policies adequately governing the structure and organization of the Company's operations;

(f) To establish guidelines and policies adequately governing the standards for credit approval, investment activities and the auditing process;

(g) To establish guidelines and policies adequately governing Wells Fargo's accounting practices and its investments;

(h) Not to violate, or knowingly permit any officer, director or employee of Wells Fargo to violate applicable federal laws, rules and regulations;

(i) To exercise reasonable control and supervision over the officers and employees of Wells Fargo;

(j) To maintain a proper division of authority and responsibility among the officers and directors of Wells Fargo so as to prevent the dominance of any officer or director in the conduct of the business and affairs of Wells Fargo;

(k) To exercise reasonable care in evaluation of the prudence and soundness of policies and practices proposed to be undertaken by Wells Fargo;

(l) To ensure that Wells Fargo did not engage in unsafe, imprudent or unsound practices and to become and remain informed as to how Wells Fargo was, in fact, operating;

(m) Upon receiving notice or information of an unsafe, imprudent or unsound practice, to make a reasonable investigation of the matter and to take steps to correct that condition or practice;

(n) To establish and maintain systematic and accurate books and records of the business and affairs of Wells Fargo and procedures for the reporting of the business and affairs to the Board of Directors and periodically to investigate, or cause independent investigation to be made of, the books and records;

(o) To maintain and implement an adequate and functioning system of internal financial, accounting and lending controls and management information systems, such that Wells Fargo's assets would be safeguarded, its financial statements and information would be accurately recorded and reported and corporate managers would be given prompt notice of serious problems or divergences so that risk to the corporation would be minimized; and

(p) To supervise the preparation and filing of any audited or unaudited financial statements, reports or other information required by law from Wells Fargo, to examine and evaluate any reports of examination, audits or other information required by federal or state law concerning the financial condition of Wells Fargo and to make full and accurate disclosure of all material facts concerning, *inter alia*, each of the subjects and duties set forth above.

CONSPIRACY, COMMON COURSE OF CONDUCT AND AIDING AND ABETTING

34. Prior to the beginning of the Class Period, the Defendants, and each of them, began a course of conduct which was designed to and did (i) deceive the investing public, including Plaintiffs and the other Class members, regarding Wells Fargo's business, markets, results of operations, financial condition and its future business prospects; (ii) conceal the Individual Defendants' gross mismanagement of Wells Fargo and the Defendants' falsification of Wells Fargo's financial statements; (iii) artificially inflate the market price of Wells Fargo common stock during the Class Period; (iv) inflate the compensation certain Defendants would receive as officers of Wells Fargo; and (v) cause Plaintiffs and other members of the Class to purchase Wells Fargo's common stock at inflated prices. In furtherance of this plan and course of conduct, the Defendants took the actions as herein set forth.

35. The Individual Defendants participated in the wrongdoing complained of herein in order to continue and prolong the image of Wells Fargo as a well-managed enterprise with sound lending procedures and vigorous credit review procedures which was achieving profitability and in order to conceal the adverse facts concerning the Company's markets, business, management, financial condition and future business and earnings prospects, so that they could (i) protect and enhance their executive positions and the substantial compensation and prestige they obtained thereby; (ii) enhance the value of their personal Wells Fargo securities holdings and options; and (iii) inflate the apparent profits of the Company in order to obtain

larger payments under Wells Fargo's incentive bonus compensation plan and/or individual performance discretionary bonuses.

36. The conspiracy, common enterprise and common course of conduct that commenced in or about March 1991 involved all of the Defendants named herein. The purpose and affect [sic] of the conspiracy, common enterprise and common course of conduct complained of was, *inter alia*, to inflate the market price of Wells Fargo's common stock in violation of the anti-fraud provisions of the federal, securities laws and statutory and common laws and obscure and delay the disclosure of the horrible results of Defendants' failure to (i) observe prudent lending practices; (ii) adequately monitor Wells Fargo's loan portfolio; and (iii) establish adequate loan loss reserves. The Defendants accomplished their conspiracy, common enterprise and common course of conduct by artificially inflating the price of Wells Fargo common stock for as long as possible through the issuance of the series of false and misleading annual and quarterly reports, financial statements, and press releases as particularized herein. Each Defendant was a direct, necessary and substantial participant in the conspiracy, common enterprise and common course of conduct complained of herein.

37. Each of the Defendants named herein aided and abetted and rendered substantial assistance in the accomplishment of the fraud complained of herein. In taking the action, as particularized herein, to aid and abet and substantially assist the commission of the fraud complained of, each Defendant acted with an awareness of the primary wrongdoing and realized that its/his conduct would substantially assist the accomplishment of that fraud and was aware of its/his overall contribution to and furtherance of the conspiracy, common enterprise and common course of conduct. Defendants' acts of aiding and abetting include, *inter alia*, all of the acts each of them are alleged to have committed in furtherance of the conspiracy, common enterprise and common course of conduct complained of above except those relating to the reaching of agreements or understanding sufficient to categorize their conduct as conspiratorial.

38. As members of the Board of Directors of Wells Fargo, the directors named herein as Defendants were themselves directly responsible for authorizing or permitting authorization of, or failing to monitor, the practices which resulted in the huge losses suffered by Wells Fargo as alleged herein. Each of them had knowledge of and actively participated in and approved of the wrongdoings alleged or abdicated his responsibilities with respect to these wrongdoings. The alleged acts of wrongdoing were committed outside of normal banking practices and subjected Wells Fargo to unreasonable risks of loss.

39. Each of the Individual Defendants is liable as a direct participant in, an aider and abettor of, and co-conspirator with respect to, the wrongs complained of herein. Each of the Individual Defendants reviewed or was aware of each of the alleged misleading reports and statements complained of herein at or about the time they were issued or circulated, knew of or recklessly disregarded their false and misleading nature and was in a position to control or influence the content of such reports or otherwise cause corrective/accurate disclosures to have been made.

40. All the Individual Defendants engaged in a conspiracy, common enterprise or common course of conduct, the purpose and effect of which was, *inter alia*, to artificially inflate and support the market price of Wells Fargo publicly-traded securities. The Individual Defendants accomplished their part of the conspiracy, common enterprise or common course of conduct by artificially inflating the price of Wells Fargo common stock in the public markets through the issuance of materially false and misleading reports filed with the SEC, annual and quarterly reports to shareholders, releases to the public and financial statements in each of these as particularized herein. Additionally, the Individual Defendants, because of their positions of control and authority as officers and/or directors of the Company, were able to and did control the conduct of Wells Fargo's business as well as the contents of the various annual and quarterly reports, press releases and the statements of the Company and financial statements in each of these. As officers and/or directors of a publicly-held company, the Individual Defendants had a duty to promptly disseminate accurate and truthful information with respect to the Company's opera-

tions, products, management, projections and forecasts, so that the market price of the Company's common stock would be based on truthful and accurate information.

CLASS ACTION ALLEGATIONS

41. This action is brought by Plaintiffs and the Class pursuant to Rules 23(a) and 23(b)(3) of the Federal Rules of Civil Procedure on behalf of all persons and entities who purchased the common stock of Wells Fargo during the period from March 5, 1991 through June 25, 1991, and were damaged thereby. Excluded from the Class are the Defendants, the members of Defendants' immediate families, any entity in which any of the Defendants has a controlling interest, any employees, officers or directors of any of the Defendants, and the legal representatives, heirs, successors and assignees of any of the Defendants.

42. A significant number of Wells Fargo shares were actively traded on NASDAQ, and the New York and Pacific Stock Exchanges, all effective national markets, during the Class Period. There are in excess of 30,000 shareholders of the some 50,000,000 shares of common stock of Wells Fargo which are concurrently issued and outstanding. The members of the Class are so numerous that individual joinder of all members is impracticable.

43. There are common questions of law and fact which predominate over any questions affecting only individual Class members. Among the common questions of law and fact are the following:

(a) Whether Defendants made material misrepresentations and omissions to the Class regarding the financial health of Wells Fargo;

(b) Whether Defendants acted willfully, recklessly or negligently in omitting and/or misrepresenting material facts;

(c) Whether Defendants' conduct violated federal securities laws, including §10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder; and relevant California state law:

(d) Whether the Company's reports to the SEC on Form 10-K and 10-Q, its reports to shareholders, and its other publicly filed and disseminated documents and other statements disseminated to the Class omitted and/or misrepresented material facts about the business and finances of the Company;

(e) Whether the market price of Wells Fargo's common stock was artificially inflated due to the conduct of Defendants, including the alleged non-disclosures and/or misrepresentations complained of here;

(f) Whether Defendants participated in and pursued the conspiracy and common course of conduct complained of here; and

(g) The extent of damages sustained by Plaintiffs and the Class, and the proper measure of damages.

44. The Individual and Representative Plaintiffs' claims are typical of the claims of the members of the Class. Plaintiffs are members of the Class they seek to represent in that they purchased shares of Wells Fargo common stock at an artificially inflated price within the Class Period, and were injured by the same wrongful conduct that injured the other members of the Class.

45. Plaintiffs will fairly and adequately protect the interests of the members of the Class. Plaintiffs have retained counsel who are experienced and competent in class action litigation under the federal securities laws. The Plaintiffs have no interest which are [sic] adverse or antagonistic to the interests of the Class.

46. Plaintiffs know of no difficulty that will be encountered in the management of this litigation that would preclude its maintenance as a class action.

47. The names and addresses of the records [sic] owners of Wells Fargo common stock purchased during the Class Period are available from Wells Fargo and/or Wells Fargo's transfer agent. Notice can be provided to such record owners, via first class mail, using techniques and a form of notice similar to those similarly and regularly employed in class actions arising under the Federal Securities laws.

48. A class action is superior to any other available method for the fair and efficient adjudication of this controversy. Because the damages suffered by individual Class members may be relatively small, the burden and expense make it impracticable for Class members to seek redress individually for the wrongs done to them. The management of this lawsuit as a class action presents far fewer management difficulties than individualized actions and provides the benefits of unitary adjudication, economy of scale and comprehensive supervision by a single court.

FACTUAL BACKGROUND

49. Defendant Wells Fargo, parent of Wells Fargo Bank, N.A. (the "Bank"), is a holding company engaged in the real estate and financial services business. Wells Fargo common stock is registered with the SEC pursuant to §12(b) of the Exchange Act and its common stock is listed and actively traded on NASDAQ and on the New York and Pacific Stock Exchanges in an efficient market. Wells Fargo has at least 50,000,000 shares of common stock outstanding held by approximately 30,000 owners of record.

50. Prior to the Class Period, Wells Fargo aggressively courted the business of promoters of leveraged buy-outs ("LBO's") and other similar transactions, as well as highly speculative real estate developers. Wells Fargo rapidly built a large portfolio of risky HLT Loans, as well as construction and development loans. These loans were particularly attractive to Wells Fargo, as they allowed the Company to immediately account for substantial amounts of up-front commitment and other fees.

51. Prior to and during the Class Period, Defendants witnessed a substantial deterioration of the quality of Wells Fargo's loan portfolio. This deterioration was most noticeable in Wells Fargo's HLT Loans and its real estate and commercial loans, which were, to a substantial degree, not fundamentally sound and prone to non-repayment in foreseeable and predictable economic downturns. During this time period, Defendants were aware of a national and local economic downturn, the weakening of Wells Fargo's local real estate portfolio and Wells Fargo's significant exposure in local real estate and development projects with questionable prospects for repayment. At no time prior to June 25, 1991 did Defendants reveal the extent of Wells Fargo's speculative lending activities and the resulting consequences.

52. Throughout the Class Period, Defendants also portrayed to the public that it was "business as usual" at Wells Fargo. In fact, Defendants knew, or were reckless in ignoring facts which should have made them know that Wells Fargo had granted numerous loans which presented unacceptable risks of non-payment and loss due to, *inter alia*, the substantial decline in its local real estate loan portfolio, the terms of the loans and/or the financial weakness of the borrowers. Moreover, despite their knowledge of the decline and signs of non-payment, Defendants also intentionally or, at a minimum, recklessly maintained inadequate reserves and established inadequate provisions for loan losses for Wells Fargo's HLT and real estate loans, all of which was intended to conceal from the investing public and the federal banking regulators how poorly Wells Fargo had been managed by the Individual Defendants and how badly its financial and operating condition had deteriorated.

53. Throughout the Class Period, Wells Fargo was in frequent telephonic and personal contact with stock market professionals, analysts, money managers, institutional investors and similar members of the professional investment community, in part through activities of various officers and directors who periodically (and at least monthly) provided information to gatherings of securities analysts to promote the Company and purportedly to inform the investment community of the current status and near and long-term prospects of the Company. At these presentations and in other formal and infor-

mal contacts, the Defendants consistently advised, stated and confirmed to analysts and other stock market professionals that Wells Fargo would achieve substantially increased revenues and earnings in 1991 and that Wells Fargo had accurately and adequately evaluated and valued non-performing assets in the Company's loan and real estate portfolios and established adequate loan loss reserves. There was no reasonable basis for these forecasts when made, and the true adverse facts about Wells Fargo's markets, asset values, level of non-performing assets, financial condition, and future business prospects, which were known to or recklessly disregarded by Defendants, contradicted the forecasts as made and made it very unlikely that such increased earnings would be achieved. These statements were materially false and misleading when made and operated to artificially inflate the market price of Wells Fargo common stock during the Class Period.

54. Under banking regulations, a highly-leveraged transaction is a financial transaction that exceeds $20 million and involves the buyout, acquisition or recapitalization of an existing business. In addition, the transaction at least doubles the Company's liabilities and results in a leveraged ratio of higher than 50%, or the transaction results in a leveraged ratio higher than 75%, or the transaction is designated a highly-leveraged transaction by a syndication agent. As of March 31, 1991, Wells Fargo had over $3.5 billion worth of HLTs.

55. Each quarter, a financial institution must maintain its loan loss reserves, and is required to add an appropriate provision for loan losses, which is necessary to maintain the reserves at an appropriate level consistent with the risk of loss actually faced. In determining the amount of the loan-loss provisions and reserves, a bank or holding company such as Wells Fargo is required to consider, *inter alia*, (i) the current trend of delinquencies; (ii) excessive loan renewals and extensions; (iii) the absence of current financial data related to borrowers and guarantors; (iv) the borrower's current condition, such as whether it is experiencing operating losses, marginal working capital, or inadequate cash flow; (v) loans secured by collateral that is not readily marketable or is susceptible to deterioration in realizable value; and (vi) loans in areas or businesses experiencing economic instability.

56. Depending on the risk associated with a particular transaction, the bank is required to set aside an appropriate amount of funds in its loan loss reserves to compensate for the high risk of such transactions. In the first quarter of 1991, Wells Fargo "set aside" only $85 million for loan losses.

57. Provisions for loan losses are to be recorded on a bank's financial statements, and were recorded on Wells Fargo's financial statements, as a direct charge to, and reduction from, net income, and, thus, earnings per share. Accordingly, Defendants knew that if they established the necessary and adequate provision for loan losses given Wells Fargo's risky real estate and HLT Loans, such disclosures would have had a substantial negative impact on Wells Fargo's earnings and on the Company's ability to comply with capital requirements imposed by the banking authorities. The Individual Defendants were also aware that if they truthfully described Wells Fargo's deteriorated financial position in regard to, *inter alia,* its sub-standard and high-risk HLT and real estate loans, their highly lucrative positions as officers and directors would be jeopardized and the market prices of Wells Fargo securities would also be negatively impacted. Such disclosures, if they had been made, would have at a minimum been an early warning sign that Wells Fargo was an extremely high-risk speculation and not "safe and stable" as portrayed by Defendants. Defendants made efforts to conceal the truth that would eventually be revealed on June 25, 1991: that Wells Fargo's financial condition and loan portfolio required massive additions to its loan loss reserves.

58. Prior to and during the Class Period, Defendants knew, or were reckless in disregarding facts which indicated that Wells Fargo's commercial, HLT and real estate loan portfolios were in serious distress and, consequently, that Wells Fargo's loan loss reserves, especially in connection with HLT and real estate development loans, were woefully inadequate and presented a misleading picture of the Company's true earnings. Had Defendants accurately reflected the poor quality of Wells Fargo's loan portfolio in its loan loss reserves, either no profits would have been reportable and a loss would have resulted or, to the extent there might have been profits, such profits would have been minimal. Nonetheless, Defendants intentionally or reck-

lessly withheld this information, in order to inflate the Company's earnings and enrich the Individual Defendants as a result of the Wells Fargo compensation plans.

59. As described above, prior to and during the Class Period, Wells Fargo aggressively courted the business of promoters of HLTs. As a result, Wells Fargo quickly built upon one of the largest portfolios of HLT Loans in the country. It was also one of California's largest sources of financing for speculative real estate development. When the promoters of HLTs and real estate developers began to experience financial difficulties and/or problems in repaying the loans prior to and at the beginning of the Class Period, Defendants were on notice that a substantial portion of Wells Fargo's outstanding HLT Loans and real estate loans were in jeopardy, particularly in light of the information that was available to the Individual Defendants as sophisticated officers and directors of this major bank holding company.

60. Defendants, however, did not disclose these facts nor did they establish adequate provisions for loan losses on these loans. Among the high-risk HLT Loans for which Defendants were on notice of these problems were, *inter alia*, Revco D.S., Insilco Corp., Charter Medical Corp., R.H. Macy & Co., Campeau Corp., Jim Walters Corp., Gaylord Container Corp., West Point Pepperell, Inc., and NWA, Inc.

61. To the extent Defendants reviewed the financial condition of the promoters of the HLT Loans, including those referred to in the preceding paragraph, the likelihood of non-payment on their loans, and the enormous risk associated with those loans through all or most of the Class Period, the Individual Defendants or their subordinates either did not critically examine or assess the adverse situation relating to these loans. It was not until concern over the banking regulators' examination of Wells Fargo in the spring of 1991 (through the Shared National Credit Regulatory Examination and otherwise) became public that the Individual Defendants caused management to critically review Wells Fargo's HLT Loans and determined that, in many of these loans, which were at all times speculative and highly

risky, the likelihood of default had increased dramatically. Although the borrowers' financial condition had greatly deteriorated prior to the commencement of the Class Period, Defendants still failed to disclose to the public and regulators the fact of this deterioration.

62. Prior to the Class Period, Wells Fargo made numerous speculative loans which, in the aggregate constituted a material portion of Wells Fargo's total loan portfolio. A substantial portion of these loans made little or no economic sense for Wells Fargo in light of the prevailing market and other conditions as described here. As a result, Defendants were aware, or were reckless in disregarding facts which indicated that, at the time these loans were made, it was highly probable that these loans would go into default. Even for those loans made well before the Class Period, Defendants knew, at least by the commencement of the Class Period, that it was likely that these loans would become non-performing (if they were not already non-performing) and require the establishment of substantial additional loan loss reserves. Despite their knowledge of these facts, Defendants intentionally and/or recklessly established inadequate loan loss reserves for these HLT Loans and real estate loans, all of which artificially inflated Wells Fargo's reported earnings, assets and net worth, by material amounts.

63. The Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of Thrift Supervision regularly promulgates instructions and regulations regarding the operations of financial institutions such as Wells Fargo. Throughout the Class Period, Wells Fargo intentionally or recklessly disregarded certain of these instructions, including, *inter alia,* instructions regarding public disclosures.

64. On January 25, 1991, the Office of the Comptroller of the Currency issued Banking Bulletin No. 91-05. The Banking Bulletin was issued to "encourage national banks to consider providing more detailed information in public disclosures about non-accrual loans." The January 25, 1991 Banking Bulletin provided a sample disclosure form which provided for, *inter alia,* full disclosure of information regarding loans placed on non-accrual status.

65. On March 1, 1991, the Office of the Comptroller of the currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of Thrift Supervision issued a joint agency policy statement ("Joint Statement") concerning non-accrual assets, and highly leveraged transactions. The four agencies, which supervise over 12,000 commercial banks and 2,400 thrift institutions, indicated that the purposes underlying regulatory and accounting policies were to "encourage disclosure about the condition of" financial institutions' loan portfolios. The guidelines and statements were released, *inter alia*, to "encourage enhanced disclosure to the public" and "to better assure sound assessments of the value of real estate."

66. The four federal regulatory agencies fully supported the Office of the Comptroller of the Currency's previous Banking Bulletin (Banking Bulletin No. 91-05) issued on January 25, 1991. The Joint Statement went on to indicate that "*enhanced disclosure will help ensure that the public is better informed about the nature of institutions' portfolios.*"

67. With respect to enhanced disclosure, the Joint Statement indicated that "the simple total of such [non-accrual] loans on an institution's books may not be a good indicator of the institution's financial position." The federal regulatory agencies issuing the statement fully supported the disclosure of the type requested by the Office of the Comptroller of the Currency in the January 25, 1991 Bulletin.

68. With respect to valuation of real estate loans, the Joint Statement indicated that "it is important that valuation techniques reflect *not only existing market conditions, but also reasonable expectations of the property's performance in the market over time.* The federal regulatory agencies are reiterating their policy on the assessment of real estate values and the establishment of loan loss reserves." The statement went on to warn that "the basic thrust of this guidance is to ensure that income property loans not be assessed solely on the basis of liquidation values but also on the income-producing capacities of the properties over time. *Supervisory evaluations should take into account*

the lack of liquidity and cyclical nature of real estate markets and temporary imbalances in the supply and demand for real estate that may occur."

69. With respect to multiple loans to one borrower, the Joint Statement went on to require that when one loan to a borrower is placed on non-accrual status, the institution is required to evaluate its other extensions of credits to the one borrower to determine whether one or more of the other assets must also be placed on non-accrual status.

70. Adopting the policy discussed in Banking Bulletin No. 91-05, the Joint Statement stated that the current public disclosure about non-accrual assets, generally limited to the total amount of non-accrual assets, interest income and interest foregone, is insufficient to fully disclose the impact that non-accrual assets have on earnings and financial conditions of a particular financial institution. Accordingly, the Joint Statement suggested that these institutions make additional disclosures about non-accrual assets "in their annual reports." The Joint Statement provided a sample disclosure statement, which listed specific, important and material information regarding, past due substantial performance, limited performance, principal or interest in doubt, and the like. This was the adoption of the sample disclosure form set forth in Banking Bulletin No. 91-05.

71. With respect to HLTs, the Joint Statement indicated that once an individual credit is designated as an HLT, all current outstanding and future obligations by the same borrower are considered HLT Loans.

72. On May 20, 1991, the Office of the Comptroller of the Currency issued Banking Bulletin No. 91-19 regarding non-accrual loans. Banking Bulletin No. 91-19 specifically stated that a bank with more than one loan to a borrower must reevaluate *all* loans to the borrower if any loan to that same borrower is placed on non-accrual status. The Banking Bulletin stated, "in summary, when a bank places one loan to a borrower on non-accrual status, a bank should reevaluate" whether the borrower's other loans should also be placed on non-accrual.

73. With respect to payments for non-accrual loans, the Office of the Comptroller of the Currency indicated that, if repayment of principal is not expected, payments received should be applied to the principal "to the extent necessary to restore the expectations of alternate collectibility." The loans should be placed on non-accrual status and payments should be made to reduce loan balance. This also requires non-accrual status for "all partially charged-off loans." The Banking Bulletin indicated that a loan is non-accrual when the borrower is unable to pay principal and interest when due. The Banking Bulletin also stated that "under existing regulatory policy, when a bank records a partial charge-off on a loan, it cannot continue to accrue interest income on that loan."

PUBLIC STATEMENTS AND REGULATORY FILINGS CONTAINING MISREPRESENTATIONS AND OMISSIONS OF MATERIAL FACT

74. During the Class Period, Defendants made public statements which were designed to conceal the facts set forth above, namely that Wells Fargo was experiencing serious payment problems on its HLT Loans and real estate loans, or was anticipating significant losses as a result of its substantial portfolio of HLT Loans, real estate construction and mortgage loans from at least the commencement of the Class Period. Despite knowledge of Wells Fargo's deteriorating loan portfolio, and the regulatory agencies' concern with proper accounting for loans placed on non-accrual status, Defendants made the statements detailed below concerning the purported actual and expected financial condition and performance of Wells Fargo. These statements were materially false and misleading in that they misstated and omitted to state material facts concerning the then-existing financial condition and loan portfolio of the Company and were made as a means to reassure the investment community that Wells Fargo was a conservative, growing institution with high asset quality, despite the ever-mounting deterioration of its condition caused by, *inter alia*, the HLT Loans, the speculative real estate ventures, and other high-risk loans made by Wells Fargo.

75. On or about March 5, 1991, in its 1990 Annual Report, Wells Fargo reported its net income for the fourth quarter and the full year of 1990. In the 1990 Annual Report, Defendants reassured the investing public:

> The year 1990 was marked by the threat of war in the Persian Gulf, a faltering economy and a continuous stream of bad news affecting the nation's financial services industry.
>
> In these unsettled times, investor concerns about what lay ahead for Wells Fargo and the California economy largely overshadowed the Company's steady financial performance.
>
> Net income for the year rose 18%, to $711.5 million. Earnings per common share were $13.39, an increase of 22% in comparison with last year's $11.02 per share.
>
> * * *
>
> Defensive actions — *redoubling surveillance of our real estate and corporate loan portfolios,* working out arrangements with delinquent borrowers, trimming back corporate and real estate banking activities, increasing loan loss reserves, and strengthening the Company's capital base — occupied an increasingly important place in our day-to-day agendas.
>
> * * *
>
> With the bulk of its loans and practically all of its deposits concentrated in California, Wells Fargo Bank has been a major contributor to — and beneficiary of — the state's economic growth.
>
> * * *
>
> *In short, we remain optimistic about California's prospects — and we still believe that our sharply focused regional marketing strategy is right for Wells Fargo. Over the years Wells Fargo has adopted a number of lending practices, pricing policies and credit standards designed to compensate for, and partly offset, the risks inherent in banking real estate and corporate credits.* These practices have worked well for us in the past, and *we believe they are especially appropriate to today's relatively high-risk banking environment.*

* * *

> Over the years Wells Fargo has adopted a number of lending practices, pricing policies and credit standards designed to compensate for, and partly offset, the risks inherent in banking real estate and corporate credits. These practices have worked well for us in the past, and we believe they are especially appropriate to today's relatively high-risk banking environment.
>
> But in the final analysis, whatever success we've had in corporate and real estate lending is due to two things: good customers and a well-seasoned team of senior lending officers.

* * *

> Among other things, experience has taught us to anticipate and react quickly to potential problems — and to recognize small problems before they become big ones. It has also taught us to place as much faith in our analysis of our borrowers' integrity and their ability to pay as in the value of their collateral.

76. Against this backdrop of calm reassurance, Defendants further stated with respect to Wells Fargo's HLT Loans in the Company's 1990 Annual Report:

> During the 1980s, Wells Fargo's Corporate Banking Group assisted in financing the restructuring, acquisition or buyout of slightly more than one hundred American corporations. Typically, Wells Fargo acted as lead banker and senior lender in these highly leveraged transactions (HLTs), providing secured term loans with average maturities of five to seven years. Normally, repayment schedules were based on reasonable projections of cash flow from operations, rather than the sale of corporate assets.

* * *

> The risks related to our HLT portfolio differ in two significant respects from those involved in real estate lending. First, the HLT portfolio is widely diversified, both geographically and by industry. Second, our experience in this type of lending has not been tested by recession. These differences make it more difficult to anticipate how the HLTs

> as a group will perform over the next 12 months. All we can say with certainty is that *we will be exercising even more than our customary diligence in managing our HLTs as well as all other segments of our loan portfolio in coming months.*

77. With respect to Wells Fargo's HLT Loan portfolio, Defendants stated in a table appearing at page 16 of the 1990 Annual Report:

> The Company believes at the present time that these loans are substantially secured by the assets of the borrowers. In addition, at December 31, 1990 and 1989, senior HLT loans past due 90 days and still accruing were $8 million and $209 million, respectively. There were no HLT loans on restructured status and there was no ORE resulting from HLT loans at December 31, 1990 and 1989. Senior HLT loans of $36 million and $30 million were charged off in 1990 and 1989, respectively. During an economic downturn or a sustained period of rising interest rates, HLT borrowers may experience a decrease in their financial performance greater than that of non-HLT borrowers.

78. With respect to other than HLT Loans, Defendants supplied numerous charts and tables, none of which warned the investing public of the full extent of the risks inherent there. Further, on page 18 of the 1990 Annual Report, Defendants advised shareholders that substantially all of Wells Fargo's commercial loan net charge-offs in 1990 were related to HLTs, implying that the Company's remaining loans were quite healthy. Defendants went on to say, without basis in fact, that:

> The Company's determination of the level of the allowance, and correspondingly, the provision for loan losses rests upon various judgments and assumptions including, but not limited to, general economic conditions, loan portfolio composition and prior loan loss experience. The Company considers the allowance for loan losses of $885.4 million adequate to cover losses inherent in loans; commercial, real estate and other loan commitments; and stand-by letters of credit as of December 31, 1990.

79. Such statements and others were utterly deceptive in that they concealed the fact that many of the Company's HLT Loans and major real estate development loans were already high-risk, that the

borrowers already faced serious risk of failure of timely repayment, and that the Office of the Comptroller of the Currency (and other regulatory agencies) had issued regulations requiring banks, such as Wells Fargo, to increase loan loss reserves, re-evaluate loans and to place certain loans on non-accrual status, when appropriate.

80. On April 16, 1991, and in subsequent SEC filings in the first quarter Report to Shareholders, Wells Fargo reported that its earnings per share on the first quarter of 1991 were $2.86 on net income of $152 million. Wells Fargo stated it had made a loan loss provision of $85 million and represented that those financial results included all adjustments and provisions necessary for fair presentation of its results in conformity with Generally Accepted Accounting Principles ("GAAP"). Wells Fargo's first quarter earnings as reported were well in excess of analysts' expectations, due, in large part, to the modest size of the loan loss reserve provision. As a result, Wells Fargo stock jumped over $4 per share to over $76 and continued to increase to over $90 per share during the balance of the Class Period.

JUNE ANNOUNCEMENTS

81. In a June 10, 1991 article in *Barrons* Financial Weekly, the Company dismissed the claim that Wells Fargo might face a possible increase in non-performing real estate loans for the second quarter of 1991. Rather, the Company noted that for the past 16 years, Wells Fargo averaged only "0.13" of a percentage point in real estate lending losses.

82. On June 18, 1991, Wells Fargo announced that its Board had declared a regular quarterly dividend of $1.00 per share. On June 24, 1991, Wells Fargo stock fell sharply. In response to inquiries, Wells Fargo stated that "*it knew of no reason to explain*" the drop in its stock prices.

83. Despite the promising picture painted by Wells Fargo and the Individual Defendants, on June 25, 1991, Wells Fargo requested that the New York Stock Exchange delay the opening of trading of its stock, pending an announcement to be made by Wells Fargo.

84. On June 25, 1991, Wells Fargo announced that it would increase its reserves for loan losses in the second quarter of 1991. The Company announced that it expected to have a second quarter provision for loan losses of approximately $350 million. This loan loss reserve was approximately four times the $85 million loan loss reserve for the first quarter of 1991. This increase raised the total loan loss reserved to a total of over $1 billion.

85. The Company also announced that it expected actual loan losses in the second quarter to be approximately $180 million. This amount was over two and one-half times the $67 million in loan losses reported for the first quarter of 1991.

86. Due to the increase in previously unannounced loan losses, Wells Fargo estimated that its net income for the second quarter of 1991 would be approximately $15 million or approximately 20 cents per common share. Wells Fargo also announced that it would be placing $40 million of commercial loans on a "non-accrual" basis. Wells Fargo's announcement of 20 cents per share was based on a formerly undisclosed $35 million write-off for losses due to Wells Fargo's investments in HLTs and bad loans. Prior to the announcement it was widely believed that Wells Fargo's net income would be much greater.

87. The Company also announced that approximately half of the loans placed on non-accrual were HLTs.

88. As a result of this public disclosure of previously withheld information, the value of Wells Fargo stock plummeted: after the announcement, the stock declined from the previous high of $97 per share to $74 per share.

89. The reasons for Wells Fargo's downturn were known, or should have been known, to Defendants at the commencement of, and throughout, the Class Period, and were wrongfully and illegally withheld from Plaintiffs and the Class.

90. By reason of the foregoing uniform false and misleading statements, and concealments and non-disclosures, the market price of

Wells Fargo stock was artificially inflated at all times during the Class Period.

91. Due to the Defendants' false statements about Wells Fargo's business and earnings, Wells Fargo's common stock traded at artificially inflated prices during the Class Period, prior to the disclosure of the previously concealed adverse information about Wells Fargo. As a result of these false and misleading statements and Defendants' failure to reveal the full truth about Wells Fargo, Wells Fargo common stock traded during the entire Class Period at artificially inflated prices until on or after June 25, 1991, when full disclosure was finally made. Plaintiffs and the members of the Class purchased or otherwise acquired the common stock of Wells Fargo during the Class Period in reliance upon the integrity of the marketplace and Defendants' false statements including Wells Fargo's false financial statements, all of which were known to Defendants, and were damaged thereby.

92. As a result of the dissemination of the aforementioned false and misleading financial statements, annual and quarterly reports to shareholders and the SEC, press releases and other public communications, the market prices of Wells Fargo's common stock were artificially inflated throughout the Class Period. In ignorance of the adverse facts concerning Wells Fargo's financial condition, which were concealed by Defendants, Plaintiffs and members of the Class purchased or otherwise acquired the common stock of Wells Fargo at artificially high prices, relying upon the integrity of the market, and were damaged thereby. Had Plaintiff and the members of the Class known of the materially adverse information not disclosed by Defendants, they would not have purchased or acquired Wells Fargo common stock and other securities at the artificially inflated prices they did.

UNDISCLOSED ADVERSE INFORMATION

93. The public announcements, financial statements and reports, SEC filings, shareholder reports and analysts' reports based thereon were each materially false and misleading. Prior to June 25, 1991, Defendants portrayed Wells Fargo as a very successful company

whose future prospects of profitable growth would be and continued to be enhanced, through the Company's capable management, excellent lending controls and credit monitoring procedures, high-quality loan portfolio and ability to control its level of non-performing assets.

94. In violation of applicable SEC rules and regulations, these public statements failed to disclose "known trends or uncertainties," *i.e.*, the material adverse information stated below, that Defendants knew would "have a material ... unfavorable impact on net sales or revenues or income from continuing operations," and also failed to disclose "material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition." Regulation S-K, Item 303(a)(3)(ii) and Instruction 3; 17 C.F.R. §229.303(a)(3)(ii).

95. Prior to and during the Class Period, Wells Fargo failed to comply, and failed to disclose its non-compliance, with the Office of the Comptroller of the Currency's policy statements and guidelines regarding, *inter alia*, (1) valuation of real estate loans; (2) recognizing non-performing loans; (3) enhanced public disclosure of non-accrual loans, and (4) evaluation of a single borrower's total extensions of credit when one loan to the borrower is placed on non-accrual status.

96. In addition, Wells Fargo failed to disclose the impact compliance or non-compliance with the Office of the Comptroller of the Currency's policy statements and guidelines would have upon the Company's earnings and profits. Specifically, Wells Fargo omitted to disclose that the Office of the Comptroller of the Currency's policies regarding HLTs, the determination of non-accrual status, evaluation of real estate loans and evaluation of all loans to a single borrower would dramatically decrease the Company's earnings for 1991.

97. The foregoing representations were each false and misleading at the time they were made, in that these statements concealed and failed to disclose, *inter alia*, the following adverse information con-

cerning Wells Fargo which was necessary to make the representations not misleading:

(a) That in order to conceal its growing amount of problem or non-performing loans and the dangers posed to Wells Fargo thereby, and to permit Wells Fargo to continue to falsely report large and increasing earnings, Wells Fargo failed to properly classify loans as problem or non-performing loans and thereby avoided establishing material amounts (over $350 million) of reserves for possible loan losses, which reserves were required in order to fully and accurately present Wells Fargo's actual financial results in conformity with GAAP and Regulatory Accounting Principles ("RAP");

(b) That Wells Fargo's first Quarter 1991 financial statements overstated Wells Fargo's assets, net income, earnings per share and stockholders' equity by material amounts because the Company failed to make timely and appropriate writedowns or establish reserves for likely losses on loans made by it;

(c) That Wells Fargo's non-performing assets and its reserves for possible loan losses were understated by at least $400 million and $350 million, respectively, due to the defaults on and doubtful collectibility of many of its loans, and that the earnings and stockholders' equity of Wells Fargo were correspondingly overstated;

(d) That because of Wells Fargo's undisclosed and understated non-performing loans and inadequate loan loss reserves, Wells Fargo's capital position was not nearly as strong as represented;

(e) That Wells Fargo was not fairly presenting or reporting its results from operations and its financial statements in conformity with GAAP and RAP, in that Wells Fargo's financial figures for the first quarter of 1991:

(i) Overstated income, assets and net worth as a result of Wells Fargo's failure to provide adequate reserves for losses on loans of doubtful collectibility;

(ii) Overstated income because interest income was being improperly accrued on non-performing loans and because loan origination fees were being recognized on loans that were uncreditworthy and did not meet Wells Fargo's lending standards or other prudent lending standards; and

(iii) Overstated retained earnings by the amount of income overstated and for the same reasons;

(f) That Wells Fargo lacked adequate internal financial and accounting controls and management information systems necessary to ensure the integrity of its assets and its resulting financial statements such that all assets, revenue and income from transactions recorded on Wells Fargo's books were reasonably expected to be realized and were not, in fact, fictitious or illusory;

(g) That Wells Fargo did not have management information systems or financial and accounting controls adequate for management to monitor, determine or accurately forecast the financial performance of the Company or evaluate the status of its loan portfolio on a timely basis;

(h) That because of the internal pressures at Wells Fargo generated from the top executive officers of Wells Fargo to report strong first quarter earnings and thus to "squeeze" short sellers of Wells Fargo stock and force the stock price up and then to purchase stock to "cover" their short position, Defendants falsified Wells Fargo's first quarter results to make Wells Fargo look far more profitable than it really was;

(i) That the quality and collectibility of Wells Fargo's loan portfolio had deteriorated significantly, largely because of the problems and actions set forth above. Unlike the Bank's traditional lending activities which involved California residential and other real estate loans, it had made over $4 billion in highly leveraged transaction loans without adequate evaluation or review of (i) the borrower's creditworthiness to determine if the borrower met Wells Fargo's standards, (ii) the adequacy or valuation of the collateral for the loans,

and (iii) the adequacy of the credit or loan documentation or its compliance with applicable state and federal regulations;

(j) That Wells Fargo's loan portfolio included at least $400 million of non-performing loans which were not timely accounted for or disclosed as such by Wells Fargo;

(k) That in order to conceal the growing amount of problem loans and the dangers posed to Wells Fargo thereby, and in order to permit Wells Fargo to continue to report earnings growth, Wells Fargo failed to properly classify loans as non-performing loans, and thereby avoided establishing material amounts of reserves for possible loan losses which were required in order to fairly and accurately present Wells Fargo's financial results, by granting unjustified maturity extensions, rate concessions and loan rollovers which were not in accord with standard practices and were not justified by the creditworthiness, current financial condition and loan performance of the borrowers;

(l) That Defendants authorized, caused or permitted Wells Fargo to make a large number of low-quality, HLT Loans, in part because its lending control and credit administration systems were inadequate to ensure proper collateralization of loans, proper valuation of collateral, compliance with Wells Fargo's documentation and lending procedures and prompt identification of problem loans and provision for their special handling and monitoring;

(m) That Defendants authorized, caused or permitted Wells Fargo to engage in an overly aggressive commercial lending program by which Wells Fargo made a significant volume of HLT Loans which Defendants knew or recklessly disregarded were of a substantially higher risk character than Wells Fargo's traditional activities and, thus, would likely result in major losses downstream;

(n) That Defendants caused or permitted the Bank repeatedly to violate 12 C.F.R. §563.161(a), requiring federal bank associations to "maintain safe and sound management" and to "pursue financial policies that are safe and consistent with ... the purposes of

federal savings associations and are appropriate to their respective types of operations";

(o) That in contravention of the rules, regulations and policies of the Office of the Comptroller of the Currency, Wells Fargo failed to properly: (i) place certain loans on non-accrual status; (ii) make additional and adequate disclosures about non-accrual loans in its annual reports and other publicly disseminated documents; (iii) evaluate real estate loans based on the ability of the collateral to generate adequate cash flow; and (iv) place multiple loans to one borrower in non-accrual status when one loan to the borrower is placed on non-accrual status;

(p) That a preliminary report of the Shared National Credit Regulatory Examination of Wells Fargo required the Company to increase its loan-loss reserves for loans placed on non-accrual status;

(q) That in contravention of the regulations promulgated by the SEC under the Exchange Act, specifically Item 303 of Regulation S-K, Defendants failed to report known trends and uncertainties regarding Wells Fargo's earnings, its loss reserves for loans and real estate, and its prospects for compliance with federal capital requirements;

(r) That, contrary to the Company's statements in its public reports that, *inter alia*, its financial statements had been prepared in conformity with GAAP and RAP and the rules and regulations of the SEC and fairly presented the Company's financial position, each of Wells Fargo's financial statements that was publicly disseminated during the Class Period in the Company's 1990 Annual Report and Quarterly Reports as of March 31, 1991, and Form 10-K and otherwise were false and misleading, in that such financial statements were not prepared in conformity with GAAP or RAP, were not prepared pursuant to the rules and regulations of the SEC, and did not reflect all adjustments necessary to present fairly the financial position, results of operations and changes in the financial position of Wells Fargo for the period or periods presented;

(s) That Wells Fargo's previously referenced financial statements violated the following GAAP principles, among others:

(i) The principle of fair presentation ("presents fairly") was violated. Statement No. 4 of the Accounting Principles Board ("APB Nos.") 4-109, 138, 189;

(ii) The principle of adequacy and fairness of disclosure was violated. APB Nos. 4-81, 106, 189, 199;

(iii) The principle of materiality concerning information that is significant enough to affect evaluations or decisions was violated. APB Nos. 4-25, 128;

(iv) The principle that the financial information presented should be complete was violated. APB Nos. 4-23, 94, 106;

(v) The principle that a conservative approach providing early recognition of unfavorable events and providing for the preservation and protection of shareholders and Company interest was violated. APB Nos. 4-28, 35, 171;

(vi) The principle that the substance of transactions rather than form should be reflected was violated. APB Nos. 4-25, 35, 127;

(vii) The principle that informed judgment based on background and knowledge should be applied was violated. APB Nos. 4-25, 35, 124, 173, 174;

(viii) The principle that items included in the financial statements be reliably corroborated by outside evidence (verifiability) was violated. APB Nos. 4-25, 35, 90;

(ix) The principle that the financial statements contain and disclose relevant, understandable and timely information for the economic decisions of the user was violated. APB Nos. 4-23, 88, 89, 92;

(x) The principle that the financial statements provide reliable financial information about the enterprise for the economic decisions of the user was violated. APB Nos. 4-77, 78, 107, 108;

(xi) The principles violated above are incorporated into the violation of the principle concerning the information contained in and disclosed, or not disclosed in, income statements. APB Nos. 4-23, 172;

(xii) Additionally, the principle that losses be accrued for when a loss contingency exists was violated. Statement of Financial Accounting Standards No. 5 (Accounting for Contingencies); and

(t) That federal regulators contemplated ordering Wells Fargo to increase its reserves for a number of loans.

ROLES AND ACTIVITIES OF OFFICER AND DIRECTOR DEFENDANTS

98. Defendants Reichardt and Hazen ("Director Defendants"), as members of the Company Board of Directors, are responsible for, participated in, conspired to bring about or aided and abetted the fraud complained of herein. Wells Fargo's Board of Directors operated as a collective entity through periodic meetings held either in person or telephonically where the Board of Directors operated as a collective entity through periodic meetings held either in person or telephonically where the Board discussed matters affecting Wells Fargo and its business and reached collective and consensual decisions as to what action to take. The members of the Board also received similar, if not identical, information from Wells Fargo executives and written reports from Wells Fargo's employees and management relating to the Company's business, including internal, periodic (including monthly) financial statements and official data and reports in advance of, at and subsequent to Board meetings in connection therewith. Corporate business of Wells Fargo at the Board level was conducted through formal resolutions passed by the directors acting collectively as is reflected in the minutes of the Wells Fargo Board of Directors. In addition, the Wells Fargo Board of Directors acted col-

lectively to issue the Form 10-K for the year ended December 31, 1990, as well as Wells Fargo's Annual Report to shareholders and quarterly reports to shareholders and the SEC for the quarter ended March 30, 1991, which reports were presented to and approved by the Board either before their issuance or shortly thereafter and, in the case of the Form 10-K, was signed by each of the directors or his duly authorized representative. Thus, because Wells Fargo's Board acted as a unit, conducted Wells Fargo's business pursuant to consensual agreements and formal resolutions as a Board, and received collectively the same information about Wells Fargo's financial condition and business prospects at or about the same time, it is appropriate to treat the members of the Board, both inside and outside directors, as a unit for pleading purposes.

99. With respect to Defendants Reichardt, Hazen, Joss, Ostler, Petrone, Zuendt, Enna, Jacobs, Leahy and Rounsaville ("Executive Officer Defendants"), each were involved in the day-to-day operations and management of the Company, and directly participated, through their respective executive positions, in the fraud alleged herein. Executive Officer Defendants Reichardt, Hazen, Joss, Ostler, Petrone, Zuendt, Enna, Jacobs, Leahy and Rounsaville were aware of the internal operations of Wells Fargo, including the fraudulent conduct described herein. Each of the Executive Officers reviewed or were [sic] aware of each of the alleged misleading reports and statements complained of herein at or about the time they were issued or circulated, knew of or recklessly disregarded their false and misleading nature and was in a position to control or influence the content of such reports or otherwise cause corrective/accurate disclosures to have been made.

100. Wells Fargo's Executive Officer Defendants operated as a collective entity through periodic meetings held either in person or telephonically where the Executive Officers operated as a collective entity through periodic meetings held either in person or telephonically where the Executive Officers discussed matters affecting Wells Fargo and its business and reached collective and consensual decisions as to what action to take. The Executive Officer Defendants also received similar, if not identical, information from Wells Fargo's

Board of Directors and written reports from Wells Fargo's employees and management relating to the Company's business, including internal, periodic (including monthly) financial statements and official data and reports in advance of, at and subsequent to meetings in connection therewith. Corporate business of Wells Fargo at the Executive level was conducted through formal resolutions passed by the directors acting collectively as is reflected in the minutes of the Wells Fargo Executive Officers. In addition, the Wells Fargo Executive Officers acted collectively to issue the Form 10-K for the year ended December 31, 1990, as well as Wells Fargo's Annual Report to shareholders and quarterly reports to shareholders and the SEC for the quarter ended March 30, 1991, which reports were presented to and approved by the Executive Officers either before their issuance or shortly thereafter and, in the case of the Form 10-K, was signed by each of the Executive Officers or his or her duly authorized representative. Thus, because Wells Fargo's Executive Officer Defendants acted as a unit, conducted Wells Fargo's business pursuant to consensual agreements and formal resolutions as Officers, and received collectively the same information about Wells Fargo's financial condition and business prospects at or about the same time, it is appropriate to treat the Executive Officers as a unit for pleading purposes.

101. The Individual Defendants, and each of them, breached their duties by their conduct, including, but not limited to, those acts and omissions outlined above and in addition:

(a) They caused or permitted Wells Fargo repeatedly to violate 12 C.F.R. §563.161(a), requiring federal banks associations to "maintain safe and sound management" and to "pursue financial policies that are safe and consistent with ... the purposes of federal savings associations and are appropriate to their respective types of operations";

(b) They further caused or permitted Wells Fargo to conduct its business in an unsafe, imprudent and dangerous manner by pursuing unsound practices including those specified herein and the concealment of such practices;

(c) They caused or permitted Wells Fargo to operate and report its financial information in a manner which was deceptive, misleading and contrary to GAAP, which overstated Wells Fargo's net worth and earnings and which concealed and minimized the size and true severity of the financial problems of Wells Fargo;

(d) They failed to institute guidelines or policies to prevent the acquisition of loans and other assets which did not meet accepted banking standards, and failed to establish internal controls sufficient to maintain asset quality; and

(e) They failed to terminate or substantially modify compensation programs which encouraged officers to generate loan and investment volume without sufficient regard for quality and stability.

102. In committing the wrongs complained of herein, the Defendants have caused Wells Fargo to repeatedly violate, the [sic] have themselves repeatedly violated federal law, including the federal securities laws, statutes and regulations relating to the operation of insured federal institutions and other applicable laws and regulations. Defendants have done this by causing Wells Fargo to violate applicable banking regulations and reporting requirements, as well as the internal controls, reporting and financial statement requirements of the federal securities laws.

103. In order to facilitate and to attempt to conceal their wrongdoing, the Officer and Director Defendants have caused or permitted Wells Fargo to maintain an inadequate system of internal financial and accounting controls such that Wells Fargo's assets have not been reasonably safeguarded against loss. Such conduct permitted the Individual Defendants, *inter alia*, to cause Wells Fargo to publicly report apparent profitable growth due to excellent controls and good management while, in fact, the Individual Defendants were squandering Wells Fargo's funds on hundreds of millions of dollars in bad loans on which Wells Fargo has suffered huge losses. In connection with the wrongdoing alleged herein these Defendants have caused and/or permitted their subordinates at Wells Fargo to make false and misleading and materially inaccurate entries in Wells Fargo's books

and records to disguise the nature of these loans and the losses on them.

FIRST CLAIM FOR RELIEF

(Sections 10(b) and 20 of the Securities Exchange Act of 1934, and Rule l0b-5 promulgated thereunder)

104. Plaintiffs reallege and incorporate paragraphs 1 through 103 above, as if set forth fully here.

105. Plaintiffs assert this First Claim for Relief individually and on behalf of all members of the Plaintiff Class against all Defendants for violations of §10(b) of the Exchange Act, 15 U.S.C. §78j(b), Rule 10b-5 promulgated thereunder, 17 C.F.R. §240.10b-5, §20 of the Exchange Act.

106. During the Class Period, Defendants, severally and in concert, directly and indirectly, participated, aided and abetted one another, and conspired with one another to participate and to aid and abet one another in a continuous course of conduct in connection with the purchase of securities in violation of §10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and by use of mails and other means and instruments of transportation and communications in interstate commerce: (a) employed manipulative devices, schemes and artifices to defraud Plaintiffs and members of the Plaintiff Class; (b) made untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and (c) engaged in acts, practices and a course of business that operated as a fraud or deceit upon Plaintiffs and the Class in connection with their purchases of Wells Fargo common stock.

107. By reason of their stock ownership, their influence over substantial or controlling stockholders or their membership on the Wells Fargo's Board of Directors and positions as executive officers of the Company, the Individual Defendants were each controlling persons of Wells Fargo within the meaning of §20 of the Exchange Act throughout the Class Period and had the power and influence to

cause, and did cause, Wells Fargo to engage in the unlawful conduct complained of herein. Because of their Board membership and/or executive and managerial positions with Wells Fargo, each of the Individual Defendants had access to the adverse non-public information about Wells Fargo's business, finances and future business prospects via access to internal corporate documents, conversations and connections with corporate officers and employees, attendance at Board meetings and committees thereof and via reports and other information provided to them in connection therewith. Each of the Individual Defendants reviewed or was aware of each of the alleged misleading reports and statements complained of herein at or about the time they were issued or circulated, knew of or recklessly disregarded their false and misleading nature and was in a position to control or influence the content of such reports or otherwise cause corrective/accurate disclosures to have been made.

108. This claim for relief is brought against each of the Defendants here as a primary violator, control person aider and abettor and co-conspirator. The Individual Defendants are liable as primary violators and aiders and abettors by virtue of their individual conduct and by virtue of their positions as controlling persons of Wells Fargo under §20 of the Exchange Act.

109. During the Class Period, Defendants knowingly or recklessly engaged in a plan, scheme and course of conduct to cause and permit issuance of materially false and misleading statements and to conceal material facts in periodic reports, press releases and other publicly disseminated material.

110. During the Class Period, Defendants issued public statements and reports, including financial statements and other reports, releases and statements as described herein, which were materially false and misleading and in violation of those provisions of federal and state law. These reports, releases and statements were materially false and misleading in that they failed to disclose material adverse information about Wells Fargo's business, results from operations, operations earnings, financial condition, management and future business prospects.

111. Further, Defendants knew, or should have known but failed to disclose, that during the time of the Class Period, Wells Fargo would not be able to pay the projected earnings per share, but in fact would only be able to pay a minimal amount due to write-offs for bad investments and portfolio declines.

112. Additionally, by the commencement of and during the Class Period, Defendants knew, should have known or were reckless in and failed to disclose, that their prior favorable statements concerning Wells Fargo's position in the industry and expected financial performance were either untrue when made, were no longer true. Defendants also knew, or should have known and failed to disclose that these statements contributed to an overall misleading impression of the financial condition and business prospects of Wells Fargo. Nonetheless, despite the above, Defendants failed to make timely, corrective disclosures and failed to correct their misrepresentations concerning the earnings and profitability being experienced and expected to be experienced by Wells Fargo during 1991.

113. At all relevant times, Defendants had actual knowledge of the materially false and misleading statements and the material omissions set forth here, and intended to deceive Plaintiffs and other members of the Class, or in the alternative, acted with reckless disregard for the truth when they failed to disclose the true facts to Plaintiffs and other members of the Class.

114. Pursuant to §20(a) of the Exchange Act, the Individual Defendants were "control persons" with respect to Wells Fargo and were responsible for the disclosures made in the press releases, public reports and other publicly disseminated documents described more fully here. The Individual Defendants knew, or recklessly disregarded, the true financial and operating condition of the Wells Fargo's loan portfolio during the Class Period, which condition was concealed from Plaintiffs and the members of the Class throughout the Class Period.

115. As a result of the wrongful acts and material misstatements and omissions complained of here, the market price of Wells Fargo common stock was artificially inflated during the Class Period.

116. Following the belated and unexpected disclosure of Wells Fargo's true financial condition, the market price of Wells Fargo common stock declined sharply, causing substantial damages to Plaintiffs and the Class.

117. During the Class Period, Wells Fargo common stock was traded on an active and efficient market. Plaintiffs and members of the Class relied upon the truth and accuracy of the representation made by Defendants because of Defendants fiduciary responsibility and/or superior knowledge, and on the integrity of the market in purchasing Wells Fargo common stock during the Class Period. As a consequence of Defendants' wrongful conduct, Plaintiffs and the members of the Class were induced to, and in fact did, purchase their Wells Fargo stock at artificially inflated prices. Had Plaintiffs and members of the Class known the materially adverse information misstated or not disclosed by Defendants, they would not have purchased their stock at the artificially inflated prices they had paid or would not have purchased the shares at all.

118. By virtue of the foregoing, Plaintiffs and members of the Class have sustained substantial damages in an amount to be proved at trial.

SECOND CLAIM FOR RELIEF

(California Civil Code §1709 — Fraud and Deceit)

119. Plaintiffs reallege and incorporate paragraphs 1 through 117 above, as if set forth fully here.

120. Plaintiffs assert this Second Claim for Relief individually and on behalf of all members of the Class against all Defendants for fraud.

121. Each of the Defendants owed to purchasers of Wells Fargo common stock, including the Plaintiffs and the other members of the Class, a duty of full disclosure, honesty and complete candor, as well as a duty to exercise reasonable care and to make a reasonable and diligent investigation of the Annual Report and quarterly reports to shareholders and all reports regularly filed with the SEC.

122. For the purpose of inducing Plaintiffs and the members of the Class to purchase Wells Fargo common stock and with the intent to deceive such persons, Defendants employed a device, scheme and artifice to defraud. As part of said device, scheme and artifice to defraud, Defendants, and each of them, actively made and perpetrated, participated in the making or aided and abetted the making or perpetration of false and misleading statements and omissions of material fact as hereabove alleged. Each such statement and omission was untrue or misleading, and Defendants did not believe them to be true or not misleading when made or recklessly made such statements without regard to their truthfulness.

123. At the time said omissions and misrepresentations of material fact were made, Plaintiffs and the members of the Class were ignorant of the falsity of said statements and believed them to be true. In reliance upon said omissions and misrepresentations of material fact, and in ignorance of the true facts, Plaintiffs and the other members of the Class were induced to purchase, and, in fact, purchased Wells Fargo common stock. Had Plaintiffs and the other members of the Class known the true facts, they would not have purchased said securities.

124. As a direct and proximate result of the wrongful conduct alleged in this cause of action, Plaintiffs and the members of the Class suffered damages in an amount to be proved at trial.

125. Defendants' fraudulent conduct was wilful, malicious and oppressive, entitling Plaintiffs and the Class to punitive damages.

THIRD CLAIM FOR RELIEF

(California Civil Code §1710 — Negligent Misrepresentation)

126. Plaintiffs reallege and incorporate paragraphs 1 through 124 above, as if set forth fully here.

127. Plaintiffs assert this Third Claim for Relief individually and on behalf of all members of the Class against all Defendants for negligent misrepresentation.

128. Defendants owed to the purchasers of Wells Fargo common stock, including Plaintiffs and the other members of the Class, a duty of full disclosure, honesty, and complete candor, as well as a duty to exercise reasonable care and to make a reasonable and diligent investigation of the statements contained in the documents described above, including all public statements, filings and reports regarding Wells Fargo that were disseminated or filed during the Class Period. Defendants also owed Plaintiffs and other members of the Class a duty to correct any previously issued statements that became false as a result of subsequent events that took place during the Class Period.

129. In breach of these duties, Defendants and each of them, negligently and carelessly issued false statements concerning material facts, or omitted to state other material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and failed to correct earlier statements that had become misleading.

130. Defendants disseminated to the Plaintiffs and members of the Class, uniform material misrepresentations regarding the financial condition of Wells Fargo.

131. Defendants made the false and misleading statements without a reasonable ground for believing them to be true and accurate.

132. The statements made by Defendants were issued for the purposes of inflating the market value of the Company's common stock.

133. Defendants' breach of their duty of care owed to Plaintiffs and the other members of the Class directly caused the price of Wells Fargo common stock to artificially inflate throughout the Class Period. Plaintiffs and the other members of the Class, who purchased Wells Fargo common stock during the Class Period, paid artificially inflated prices and suffered damages as a direct, proximate foreseeable result of Defendants' negligent misrepresentations.

134. As a proximate result of Defendants' negligent misrepresentations, Plaintiffs and members of the Class have been damaged in an amount to be proved at trial.

WHEREFORE, individual and representative Plaintiffs request of this Court the following relief, on behalf of themselves and all others similarly situated:

1. An order certifying the proposed Plaintiff Class here, under Federal Rules of Civil Procedure 23(a) and 23(b)(3), and appointing Plaintiffs and their counsel of record to represent the Class;

2. An award of money damages against Defendants jointly and severally, in favor of Plaintiffs and the other members of the Class for all losses and injuries suffered as a result of the acts and transactions complained of here, together with pre-judgment interest on all such damages which the Court shall award from the date of the wrongs to the date of judgment at the maximum rate permitted by law;

3. An award of punitive damages;

4. An award of costs and disbursements of this action, including reasonable allowances of fees for Plaintiffs' attorneys and experts and reimbursement of Plaintiffs' expenses; and

5. Granting Plaintiffs equitable relief including an attachment and/or a freeze of the Defendants' assets and/or injunctive relief against the disposition of these assets; and

6. Such other and further relief as the Court may deem just and proper.

DATE: August 26, 1991

MILBERG WEISS BERSHAD SPECTHRIE & LERACH
WILLIAM S. LERACH
JAN M. ADLER

/s/ William S. Lerach
225 Broadway, Suite 2000
San Diego, CA 92101
Telephone: 619/231-1058

LIEFF, CABRASER & HEIMANN
ELIZABETH JOAN CABRASER
WILLIAM B. HIRSCH
WILLIAM M. AUDET

/s/ William B. Hirsch
Embarcadero Center West
275 Battery Street, 30th Floor
San Francisco, CA 94111
Telephone: 415/956-1000

BERGER & MONTAGUE, P.C.
SHERRIE R. SAVETT
1622 Locust Street
Philadelphia, PA 19103
Telephone: 215/875-3000

BERMAN, DeVALERIO & PEASE
GLEN DeVALERIO
One Liberty Square
Boston, MA 02109
Telephone: 617/542-8300

GREENFIELD & CHIMICLES
RICHARD D. GREENFIELD
MARK C. RIFKIN
One Haverford Centre
Haverford, PA 19041
Telephone: 215/642-8500

GREENFIELD & CHIMICLES
R. BRUCE McNEW
One California Plaza
Suite 1640
Los Angeles, CA 90071
Telephone: 213/626-6100

GROSS & METZGER, P.C.
ANN WHITE
1500 Walnut Street
Philadelphia, PA 19102
Telephone: 215/561-3600

KAPLAN & KILSHEIMER
ROBERT N. KAPLAN
685 Third Avenue, 26th Floor
New York, NY 10017
Telephone: 212/687-1980

KOHN, SAVETT, KLEIN & GRAF, P.C.
DIANNE M. NAST
1101 Market Street
2400 One Reading Center
Philadelphia, PA 19107
Telephone: 215/238-1700

LOWEY DANNENBERG BEMPORAD & SELINGER, P.C.
RICHARD B. DANNENBERG
747 Third Avenue
New York, NY 10017
Telephone: 212/759-1504

LAW OFFICE OF ANDREW J. OGILVIE
ANDREW J. OGILVIE
300 Montgomery Street
Suite 700
San Francisco, CA 94104
Telephone: 415/981-1122

SACHNOFF & WEAVER
LOWELL B. SACHNOFF
20 South Wacker Drive
Suite 2900
Chicago, IL 60606
Telephone: 312/207-1000

WOLF, POPPER, ROSS, WOLF & JONES
LAURENCE D. PASKOWITZ
845 Third Avenue
New York, NY 10022
Telephone: 212/759-4600

[Demand for Jury Trial omitted]

RULES INVOLVED

Rule 9(b), Federal Rules of Civil Procedure:

> **(b) Fraud, Mistake, Condition of the Mind.** In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other conditions of mind of a person may be averred generally.

Rule 12(b), Federal Rules of Civil Procedure:

> **(b) How Presented.** Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: (1) lack of jurisdiction over the subject matter, (2) lack of jurisdiction over the person, (3) improper venue, (4) insufficiency of process, (5) insufficiency of service of process, (6) failure to state a claim upon which relief can be granted, (7) failure to join a party under Rule 19. A motion making any of these defenses shall be made before pleading if a further pleading is permitted. No defense or objection is waived by being joined with one or more other defenses or objections in a responsive pleading or motion. If a pleading sets forth a claim for relief to which the adverse party is not required to serve a responsive pleading, the adverse party may assert at the trial any defense in law or fact to that claim for relief. If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

(3)

Supreme Court, U.S.
FILED
JUL 15 1994
OFFICE OF THE CLERK

No. 93-1993

In The

Supreme Court of the United States

October Term, 1994

In re WELLS FARGO SECURITIES LITIGATION
WELLS FARGO & CO., et al.,

Petitioners,

vs.

HOWARD GREENWALD, et al.,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

RESPONDENTS' BRIEF IN OPPOSITION

WILLIAM S. LERACH
(*Counsel of Record*)
JAN M. ADLER
ERIC A. ISAACSON
WILLIAM S. DATO
MILBERG WEISS BERSHAD HYNES & LERACH
600 West Broadway
Suite 1800
San Diego, CA 92101
Telephone: 619/231-1058

ELIZABETH JOAN CABRASER
WILLIAM B. HIRSCH
WILLIAM M. AUDET
LIEFF, CABRASER & HEIMANN
Embarcadero Center West
275 Battery Street,
30th Floor
San Francisco, CA 94111
Telephone: 415/956-1000

Counsel for Respondents

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

23pp

QUESTIONS PRESENTED

1. Did the Ninth Circuit correctly hold that the misrepresentation element of a Rule 10b-5 cause of action was satisfied by a complaint alleging:

> a. that a bank issued financial reports which overstated earnings and assets by failing to provide adequate loss reserves for delinquent and non-performing loans;
>
> b. examples of non-performing loans which the bank failed to recognize and reserve for;
>
> c. various affirmative misstatements in public and government filings regarding the quality of the bank's loan portfolio, the adequacy of its lending procedures and credit monitoring practices, and the sufficiency of existing loan loss reserves;
>
> d. false statements in the public press denying reports that loan losses would increase in the second quarter of 1991, which were made two weeks before the announcement of unprecedented second quarter loan losses and drastic increases in loan loss reserves; and
>
> e. false statements to investors denying knowledge of any reason to explain a significant decline in the price of the bank's stock, made one day before announcement of the drastic increases in losses and loss reserves?

2. Did the Ninth Circuit correctly hold that the scienter element of a Rule 10b-5 cause of action was satisfied by a complaint alleging (d) and (e) above and, in addition:

QUESTIONS PRESENTED – Continued

a. that the bank's management was motivated to inflate earnings and assets in order to maintain their positions and maximize their executive compensation which included incentive bonuses and stock options whose value was tied to stock price; and

b. that by overstating earnings to maintain or inflate the stock price, bank management was attempting to discourage "short selling" by "squeezing" an unusually large number of short sellers who anticipated the price of the bank's stock would decline?

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

TABLE OF AUTHORITIES iv

I. STATEMENT OF THE CASE 1

II. SUMMARY OF ARGUMENT 3

III. REASONS FOR DENYING PETITION 4

A. The Ninth Circuit Opinion Articulates No Rule of Law Inconsistent With the Rules Applied In Other Circuits 6

B. To the Extent Any Minor Conflict Can Be Discerned As To Application of the Standard in Rule 9(b) Cases Involving the Adequacy of a Bank's Loan Loss Reserves, Those Issues Are Currently Before the Ninth Circuit *En Banc* In the *GlenFed* Case 13

IV. CONCLUSION 14

TABLE OF AUTHORITIES

Page

CASES

Blackie v. Barrack, 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976) 6

Christidis v. First Pennsylvania Mortgage Trust, 717 F.2d 96 (3d Cir. 1983) 5, 7

Denny v. Barber, 576 F.2d 465 (2d Cir. 1978) 7

DiLeo v. Ernst & Young, 901 F.2d 624 (7th Cir.), *cert. denied*, 498 U.S. 941 (1990) 5, 7

Greenstone v. Cambex Corp., 975 F.2d 22 (1st Cir. 1992) 11

Hanon v. Dataproducts Corp., 976 F.2d 497 (9th Cir. 1992) 8

In re GlenFed, Inc. Securities Litigation, 11 F.3d 843 (9th Cir. 1993) 11, 12, 13, 14

In re Time Warner Securities Litigation, 9 F.3d 259, 266 (2d Cir. 1993) 9

In re Wells Fargo Securities Litigation, Master File No. C-91-1944-VRW (N.D. Cal. May 20, 1994) 5

Kowal v. MCI Communications Corp., 16 F.3d 1271 (D.C. Cir. 1994) 5, 9

McGinty v. Beranger Volkswagen, Inc., 633 F.2d 226 (1st Cir. 1980) 10

Moore v. Kayport Package Express, Inc., 885 F.2d 531 (9th Cir. 1989) 14

Roots Partnership v. Land's End, Inc., 965 F.2d 1411 (7th Cir. 1992) 9

Serabian v. Amoskeag Bank Shares, Inc., [Current Binder] Fed. Sec. L. Rep. (CCH) ¶98,228 (1st Cir. 1994) 7, 11

TABLE OF AUTHORITIES – Continued

Page

Shapiro v. UJB Financial Corp., 964 F.2d 272 (3d Cir.), *cert. denied*, ___ U.S. ___, 113 S. Ct. 365 (1992) 6, 7

Shields v. Citytrust Bancorp, Inc., No. 93-7738, 1994 U.S. App. LEXIS 13465 (2d Cir. June 2, 1994) .. 11, 12

Tuchman v. DSC Communications Corp., 14 F.3d 1061 (5th Cir. 1994) 5, 10

Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 111 S. Ct. 2749 (1991) 8

Wexner v. First Manhattan Co., 902 F.2d 169 (2d Cir. 1990) 5

STATUTES, RULES AND REGULATIONS

15 U.S.C.

§ 78j(b) 1

Federal Rules of Civil Procedure

Rule 9(b) 5, 10, 13

Rule 12(b)(6) 5

Federal Rules of Evidence

Rule 201(b) 5

17 C.F.R.

§ 240.10b-5 ..... 1, 4, 6

SECONDARY AUTHORITIES

21 Charles A. Wright & Kenneth W. Graham, Jr., *Federal Practice and Procedure* (1977) § 5106 5

Daniel John Meador & Jordana Simone Bernstein, *Appellate Courts in the United States* 38 (1994) 14

No. 93-1993

In The

Supreme Court of the United States

October Term, 1994

In re WELLS FARGO SECURITIES LITIGATION
WELLS FARGO & CO., et al.,

Petitioners,

vs.

HOWARD GREENWALD, et al.,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

RESPONDENTS' BRIEF IN OPPOSITION

I. STATEMENT OF THE CASE[1]

In the decision below, a panel of the Ninth Circuit Court of Appeals reviewed plaintiffs' complaint alleging violations of Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)), and S.E.C. Rule 10b-5, and found the detailed allegations adequate for pleading purposes. The 59-page complaint names as defendants Wells

[1] Respondents accept petitioners' statement of jurisdiction and the statutes/rules at issue.

Fargo & Co., a bank holding company, and various individual officers and directors (collectively "Wells Fargo" or "petitioners").

Contrary to petitioners' assertion, this case does *not* arise out of a fall in the price of Wells Fargo & Co. common stock in June 1991. *See* Petn. at 1. The fall in stock price was merely the public market's manifestation of surprise at Wells Fargo's June 25 announcement that it would recognize $180 million in actual loan losses for the second quarter of 1991 ($67 million had been recognized in the first quarter) and that it would add $350 million to its loan loss reserve (four times the $85 million addition in the first quarter). (a-56.) The market's surprise is hardly surprising. Two weeks earlier, Wells Fargo publicly denied reports that it faced an increase in non-performing real estate loans. (a-55.) *One day* before the announcement, when the price of Wells Fargo stock fell (due presumably to leakage of information about the loan losses), the bank continued its pattern of public deception by disclaiming any knowledge of why the stock price had declined. (a-55.)

What this case arises out of is Wells Fargo's conduct in deceiving the investing public in early 1991. Wells Fargo published inaccurate financial statements which inflated earnings and assets by understating the amount of loss reserves required in light of information known to the bank concerning delinquent and non-performing loans. To further this deception, Wells Fargo made a series of affirmative misstatements concerning the quality of the bank's loan portfolio, the adequacy of its lending and credit monitoring procedures, and the sufficiency of its loan loss reserves. (a-51 – a-55.) As noted, it then

publicly denied reports of increasing loan losses at a point in time when management had to know that losses and reserves would drastically increase at the end of the second quarter. Finally, when confronted with the reality of a dramatic decline in the price of its stock, Wells Fargo first denied knowing of any reason to explain the decline and then, one day later, announced the losses and increased reserves.

The complaint specifies examples of problem loans which Wells Fargo knew were in jeopardy but which the bank failed to adequately reserve for. (a-47.) It asserts that Wells Fargo management was motivated to misrepresent the company to the investing public in order to make Wells Fargo appear to be more profitable than it was and thereby increase the value of executive compensation. (a-35 – a-36, a-38, a-47.) The complaint also alleges that by maintaining or inflating its stock price, Wells Fargo sought to discourage "short selling" in the company's stock. (a-60.)

II. SUMMARY OF ARGUMENT

In sustaining the sufficiency of the complaint, the Ninth Circuit opinion does not disagree with nor even question a single decision of another Circuit. Indeed, Wells Fargo does not appear to dispute the settled authority from the Ninth and other Circuits cited in the panel opinion for the proposition that the intentional reporting of inadequate loss reserves can state a cause of action for securities fraud. The panel opinion assumes arguendo the correctness of Wells Fargo's position that plaintiffs must allege "something more" than the mere inadequacy of the

loan loss reserves based on subsequent drastic increases to that account. It also assumes, consistent with Wells Fargo's argument, that plaintiffs must plead facts from which an inference of scienter may be drawn. Applying these legal standards, it nonetheless finds the allegations of the complaint adequate.

Wells Fargo does not dispute the correctness of the legal standards articulated by the Ninth Circuit. Rather it finds fault with the manner in which they were applied to the particular facts of this case. In attempting to disguise the true nature of its argument, Wells Fargo magnifies nonexistent or minimal conflicts among the Circuits and minimizes the fact that the issues on which it seeks review are currently pending before the Ninth Circuit *en banc* in another case.[2] Thus, even if this case could be read to create some slight conflict in tone with the law of another Circuit, that purported conflict may be resolved by a Ninth Circuit *en banc* decision in the very near future. Considering all the circumstances, it is difficult to conceive of a situation less deserving of the attention of this Court at this time.

III. REASONS FOR DENYING PETITION

Wells Fargo has asked this Court to review this case, asserting there is a drastic need for guidance in deciding the degree of particularity required in pleading a Rule 10b-5 cause of action involving the inadequacy of a bank's loan loss reserves and related misstatements.

---

[2] Significantly, no judge requested a vote on Wells Fargo's suggestion for rehearing *en banc* in this case. (a-24.)

Although petitioners cite both Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure, the substantive focus of Wells Fargo's argument is on Rule 9(b)'s particularity requirement. Virtually every case Wells Fargo cites as being contrary to the opinion below is a Rule 9(b) decision. *See, e.g., Christidis v. First Pennsylvania Mortgage Trust*, 717 F.2d 96, 99-100 (3d Cir. 1983); *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir.), *cert. denied*, 498 U.S. 941 (1990); *Wexner v. First Manhattan Co.*, 902 F.2d 169, 172-73 (2d Cir. 1990); *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1067-68 (5th Cir. 1994); *Kowal v. MCI Communications Corp.*, 16 F.3d 1271, 1277-79 (D.C. Cir. 1994).

At the same time, Wells Fargo notes in its petition to this Court that the District Court did not base its dismissal of the complaint on Rule 9(b), and it faults the Ninth Circuit for ignoring the rule in its analysis. Petn. at 3, 9. Indeed, Wells Fargo has filed a renewed motion to dismiss in the District Court, arguing that the Ninth Circuit opinion "leav[es] the Rule 9(b) issue open on remand."[3]

Wells Fargo cannot have it all ways. If its position in the District Court is correct, Wells Fargo is asking this Court to address an issue which the District Court and

---

[3] *See* Memorandum In Support of Motion to Dismiss Amended Complaint at 12 n.4, *In re Wells Fargo Securities Litigation*, Master File No. C-91-1944-VRW (N.D. Cal. May 20, 1994). Because this motion was filed after the issuance of mandate from the Ninth Circuit, it is not part of the record in this case but is subject to judicial notice. *See* Fed. R. Evid. 201(b); 21 Charles A. Wright & Kenneth W. Graham, Jr., *Federal Practice and Procedure* § 5106, at 505 (1977).

the Ninth Circuit have not yet decided. If its District Court position is incorrect, there are several additional and independent reasons why the case does not merit this Court's attention.

A. The Ninth Circuit Opinion Articulates No Rule of Law Inconsistent With the Rules Applied In Other Circuits

As framed by the Ninth Circuit opinion, the central legal issues in this case concern the requirements for pleading a 10b-5 cause of action based on the inadequacy of a bank's loan loss reserves and related allegations. Citing precedent from within and outside the Ninth Circuit (*Blackie v. Barrack*, 524 F.2d 891, 904 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976); *Shapiro v. UJB Financial Corp.*, 964 F.2d 272, 281 (3d Cir.), *cert. denied*, ___ U.S. ___, 113 S. Ct. 365 (1992)), the panel held that defendants could be subject to a claim of securities fraud where they reported financial statements which inflated income and assets by fraudulently underreserving for non-performing loans. Wells Fargo does not dispute this rather unremarkable legal principle. It has focused instead on its contention that "an increase in the loan loss reserve, without more, does not warrant an inference of fraud." (a-6.) Again, however, there is no dispute as to the applicable legal principle. The Ninth Circuit concluded that in addition to the magnitude of the increase in reserves (from $85 million to $350 million between the first and second quarter of 1991), the complaint alleges "something more" in its specification of nine examples of problem loans to corporate borrowers which Wells Fargo knew were in jeopardy. (a-6.) The complaint asserts that Wells Fargo failed to disclose the difficulties with these loans

and failed to take adequate reserves against the losses from these loans it could reasonably anticipate.

Such examples are precisely the type of particularity which two of the cases trumpeted by Wells Fargo suggest should be included in this type of complaint. *See DiLeo v. Ernst & Young*, 901 F.2d at 626-27; *Denny v. Barber*, 576 F.2d 465, 469 (2d Cir. 1978); *see also Serabian v. Amoskeag Bank Shares, Inc.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶98,228, at 99,560 (1st Cir. 1994) (citing *Wells Fargo* with approval). The court below also noted that a mere *two weeks* prior to announcing the drastic increase in reserves, Wells Fargo affirmatively denied that non-performing real estate loans would increase in the second quarter. (a-12, a-55.) To compound matters, one day before announcing the drastic increase in loan losses and reserves, Wells Fargo continued its pattern of deception by denying that it was aware of any reason for a sharp decline in the price of Wells Fargo stock. (a-55.)

Wells Fargo seeks to turn a pleading requirement into a summary judgment procedure before any discovery has taken place. Another of the cases relied on by Wells Fargo warns against precisely this approach: "In applying the first sentence of Rule 9(b) courts must be sensitive to the fact that its application, prior to discovery, may permit sophisticated defrauders to successfully conceal the details of their fraud." *Christidis v. First Pennsylvania Mortgage Trust*, 717 F.2d at 99-100.[4] Following this admonition, here the Ninth Circuit appropriately rejected Wells

---

[4] Wells Fargo not only ignores this cautionary language in *Christidis*, but also fails to acknowledge that in a later case (*Shapiro v. UJB Financial Corp.*, 964 F.2d 272), the Third Circuit applied *Christidis* and reached conclusions completely consistent with the Ninth Circuit's decision in this case.

Fargo's attempt to require the pleading of overly detailed evidentiary facts. "[T]his level of specificity," concluded the court, "is not required at the pleading stage." (a-6.)

As the Ninth Circuit recognized, plaintiffs' complaint is not limited to allegations of fraudulent financial statements. (a-9.) Plaintiffs allege a series of affirmative misstatements regarding the nature of the bank's monitoring and oversight procedures, the quality of the loan portfolio and the adequacy of the loan loss reserves. Wells Fargo takes issue with certain of these allegations which focus on management's opinions or beliefs, contending that the Ninth Circuit misapplied this Court's decision in *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 111 S. Ct. 2749 (1991). In doing so, Wells Fargo again does not argue that the Ninth Circuit applied the incorrect legal standard,[5] but merely repackages its argument that the allegations of the complaint are insufficiently particularized to show that management *knew* its statements of belief and opinion were false. Petn. at 13-14. The argument is no more persuasive in a different wrapping.

Nor can the Ninth Circuit's opinion be read to conflict with the two cases cited by Wells Fargo. All three cases apply the same legal standard: Statements of belief

---

[5] Consistent with *Virginia Bankshares*, the Ninth Circuit held that management statements of opinion or belief could be "actionable under § 10(b) [and Rule 10b-5] if 'one of three implied factual assertions is inaccurate: (1) that the statement is genuinely believed, (2) that there is a reasonable basis for that belief, and (3) that the speaker is not aware of any undisclosed facts tending to seriously undermine the accuracy of the statement.' " (a-12, quoting *Hanon v. Dataproducts Corp.*, 976 F.2d 497, 501 (9th Cir. 1992).)

and opinion are actionable if management did not actually believe the statements or if it lacked a reasonable basis for its belief. (a-12); *In re Time Warner Securities Litigation*, 9 F.3d 259, 266 (2d Cir. 1993); *Kowal v. MCI Communications Corp.*, 16 F.3d at 1277. *Time Warner* merely cites *Virginia Bankshares* as part of a conclusory assertion that the complaint in that case did not support an inference that management lacked good faith or a reasonable basis for its belief. The more detailed discussion in *Kowal* cites *Roots Partnership v. Land's End, Inc.*, 965 F.2d 1411, 1419 (7th Cir. 1992), as an example of an inadequate reserve case which was properly dismissed because the complaint " 'nowhere alleg[ed] what the company's reserves actually were, or what they should have been.' " Here, of course, the complaint alleges that the first quarter reserves of $85 million were understated by at least $350 million (a-59) and that Wells Fargo's loan portfolio included more than $400 million of non-performing loans which were not timely accounted for (a-61).

Finally, Wells Fargo asserts that the Ninth Circuit's decision is inconsistent with decisions from other circuits regarding the degree of particularity necessary to plead scienter in a Rule 10b-5 case. The bank argues a plaintiff cannot merely allege that defendants acted knowingly or recklessly, but must plead facts which give rise to an inference of scienter. It then asserts that the complaint in this case lacks sufficient facts to support such an inference.

Again, Wells Fargo has failed to identify any issue of law which would warrant the attention of this Court even before this case is resolved in the District Court. Despite

the strong argument which can be made to the contrary,[6] the Ninth Circuit assumed *arguendo* the correctness of petitioners' position on scienter and went on to hold that plaintiffs' complaint did allege facts from which scienter could be inferred. Among the facts mentioned by the court were "motive" allegations that management was induced to overstate assets and income because accurate reporting of loan losses and accurate calculation of reserves would have adversely affected executive compensation. (a-14.)

The cases cited by Wells Fargo as being inconsistent with the Ninth Circuit's decision apply the same legal standard and, as a general proposition, turn on their own particular facts. Although *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061 suggests that incentive compensation for management standing alone may be insufficient to raise an inference of scienter (*id.* at 1068-69), the court also recognized that "[t]he particularity demanded by Rule 9(b) necessarily differs with the facts of each case." *Id.* at 1067-68. Those facts here include the additional allegations that Wells Fargo was attempting to squeeze short sellers. More importantly, as the court explained in another of the cases relied on by

---

[6] Rule 9(b) provides: "In all averments of fraud or mistake, the circumstances constituting the fraud or mistake shall be stated with particularity. Malice, intent, knowledge and other condition of mind of a person *may be averred generally.*" (Emphasis added.) The second sentence of the Rule clearly qualifies the first and means that a defendant's scienter may be alleged without pleading evidentiary facts from which mental state can be inferred. *See, e.g., McGinty v. Beranger Volkswagen, Inc.*, 633 F.2d 226, 228 (1st Cir. 1980).

Wells Fargo (*Greenstone v. Cambex Corp.*, 975 F.2d 22 (1st Cir. 1992)), the nature and timing of a disclosure may readily permit the inference that company officials knew the underlying facts at an earlier time.[7] *Id.* at 26. Here it strains credulity to think that just two weeks before announcing a *four-fold increase* in loan loss reserves due in significant part to non-performing real estate loans, Wells Fargo could in good faith publicly deny reports that real estate loan losses would increase in the second quarter. And it is well-nigh impossible that Wells Fargo "knew of no reason to explain" the decline in its stock price *one day* before it announced a catastrophic increase in losses and reserves. Clearly, this final denial was merely the last public act in a course of deceptive conduct which, within hours, Wells Fargo management concluded had to come to an end.[8]

---

[7] As was the case with the Third Circuit (*see* n.4, *supra*), the First Circuit has decided a case more recently than the case relied on by Wells Fargo and reached conclusions consistent with the Ninth Circuit's decision in this case. *See Serabian v. Amoskeag Bank Shares, Inc.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶98,228.

[8] Although not cited in the petition due to its recency, Wells Fargo may rely on *Shields v. Citytrust Bancorp, Inc.*, No. 93-7738, 1994 U.S. App. LEXIS 13465 (2d Cir. June 2, 1994), which distinguishes *Wells Fargo* because it "did not discuss the pleading requirements of Rule 9(b)," but observes that "the opinion in *GlenFed* [*In re GlenFed, Inc. Securities Litigation*, 11 F.3d 843 (9th Cir. 1993)] and the dissent by Judge Trott in *Wells Fargo* are more consonant with case law in this Circuit." 1994 U.S. App. LEXIS 13465, at *26.

As we later emphasize (pp. 13-14, *infra*), because the Ninth Circuit is currently considering *GlenFed en banc*, the Circuit position on the issues raised by Wells Fargo is as yet unsettled.

In short, the decision below applies the legal standards urged by Wells Fargo, albeit reaching a conclusion with which it disagrees. In effect, everyone accepts the definition of the strike zone and we are merely disputing whether a particular pitch was over the plate. Just as an umpire will not suffer a manager arguing balls and strikes, it is not this Court's function to hear arguments over the adequacy of a particular pleading where no significant issue of law is presented.

To say there is disagreement between the Second and Ninth Circuits is at best premature. More significantly, this case creates no conflict as to the applicable legal standard. *Shields* cites the *GlenFed* panel opinion as stating the correct rule: "[W]hether the facts in the amended complaint would give rise to an inference that the Defendants either did not believe the statements or knew that the statements were false." 11 F.3d at 849; see *Shields*, 1994 U.S. App. LEXIS 13465, at *25-26. Here, the Ninth Circuit held that the complaint "allege[s] facts which provide a basis for the inference of scienter." (a-14.) The fact that the Second Circuit might have applied the same legal standard to reach a different result is no basis for a grant of certiorari.

Consistent with this analysis, each case necessarily turns on its particular set of pleaded facts. Here, for instance, although *Shields* states that allegations regarding executive compensation alone are insufficient to establish motive (1994 U.S. App. LEXIS 13465, at *19), it does not consider such allegations in combination with assertions that management was attempting to squeeze short sellers. Perhaps most importantly, *Shields* certainly *does not hold* that public denials two weeks and one day before announcing a four-fold increase in loan loss reserves cannot give rise to an inference of scienter.

B. To the Extent Any Minor Conflict Can Be Discerned As To Application of the Standard in Rule 9(b) Cases Involving the Adequacy of a Bank's Loan Loss Reserves, Those Issues Are Currently Before the Ninth Circuit *En Banc* In the *GlenFed* Case

In cataloguing the supposed conflicts created by the Ninth Circuit decision in this case, Wells Fargo mentions in a footnote that the panel opinion is even inconsistent with precedent within the Circuit, citing *In re GlenFed, Inc. Securities Litigation*, 11 F.3d 843. Without acknowledging the obvious implications, Wells Fargo then notes that *GlenFed* "is currently being reviewed by the Ninth Circuit *en banc*." Petn. at 8 n.7.

The pendency of *GlenFed en banc* eviscerates any reason for this Court's intervention in this case. In *GlenFed*, the Ninth Circuit panel squarely addressed the applicability of Rule 9(b) to a complaint alleging the inadequacy of a financial service company's loan loss reserves and related misstatements about asset quality and credit review procedures.[9] The case was argued before the *en banc* panel on April 21, 1994.

---

[9] Petitioners have taken the position in the District Court that the opinion in *GlenFed* will likely control the decision in this case:

> In both *GlenFed* and this case, plaintiffs claim that a bank and its officers and directors delayed recognition of losses when they knew or should have known that loan loss reserves were inadequate; that the composition of the loan portfolio and the nature of lending and monitoring practices exposed the institution to imminent risk of loss; that the stock price was artificially inflated; and that defendants deliberately

One of the principal purposes of the *en banc* procedure in the circuit courts is to correct panel decisions which create inter-circuit conflict. *See* Daniel John Meador & Jordana Simone Bernstein, *Appellate Courts in the United States* 38 (1994). We have explained why we disagree with petitioners that any conflict has been created, but the *en banc* hearing may moot this debate. To the extent they are inconsistent, the *en banc* decision in *GlenFed* will clearly supersede this case as an expression of Ninth Circuit law. Rather than concluding prematurely that there is a conflict among the circuits on an issue which may be raised by this case, it would seem far preferable to wait until the Ninth Circuit's position is clarified in *GlenFed*.

IV. CONCLUSION

At the pleading stage, the Ninth Circuit concluded that plaintiffs' complaint was adequate because it states sufficient facts to enable Wells Fargo to prepare a defense. *See Moore v. Kayport Package Express, Inc.*, 885 F.2d 531, 540 (9th Cir. 1989). Wells Fargo asks this Court's intercession but can identify no serious question of law presented by the case. Instead, it merely complains that the legal standard it has argued for was applied to reach a conclusion with which it disagrees.

Even if Wells Fargo's petition presented a significant legal issue, review by this Court is simply unnecessary in

---

misled the public for the purpose of artificially inflating the stock price.

Memorandum In Support of Motion to Dismiss Amended Complaint, *supra* n.3, at 12.

light of the *GlenFed* case pending *en banc* in the Ninth Circuit. There can be no functional conflict between the Ninth and other Circuits because the position of the Ninth Circuit on the issues raised by Wells Fargo is simply not settled.

In short, there is no need, no reason and no basis for this Court's intervention. We respectfully urge that the petition be denied.

DATED: July 15, 1994

Respectfully submitted,

MILBERG WEISS BERSHAD
HYNES & LERACH
WILLIAM S. LERACH
(*Counsel of Record*)
JAN M. ADLER
ERIC A. ISAACSON
WILLIAM S. DATO

WILLIAM S. LERACH
600 West Broadway, Suite 1800
San Diego, CA 92101
Telephone: 619/231-1058

LIEFF, CABRASER & HEIMANN
ELIZABETH JOAN CABRASER
WILLIAM BERNSTEIN
WILLIAM M. AUDET
Embarcadero Center West
275 Battery Street, 30th Floor
San Francisco, CA 94111
Telephone: 415/956-1000

BERGER & MONTAGUE, P.C.
SHERRIE R. SAVETT
1622 Locust Street
Philadelphia, PA 19103
Telephone: 215/875-3000

BERMAN, DEVALERIO & PEASE
GLEN DEVALERIO
One Liberty Square
Boston, MA 02109
Telephone: 617/542-8300

CHIMICLES, JACOBSEN & TIKELLIS
PATRICK J. GRANNAN
633 West Fifth Street
Suite 2200
Los Angeles, CA 90071-2010
Telephone: 213/623-8100

GREENFIELD & RIFKIN
RICHARD D. GREENFIELD
MARK C. RIFKIN
344 West Lancaster Avenue
Suite 1000
P. O. Box 259
Haverford, PA 19041-0259
Telephone: 215/649-3900

KAPLAN, KILSHEIMER & FOX
ROBERT N. KAPLAN
685 Third Avenue, 26th Floor
New York, NY 10017
Telephone: 212/687-1980

KOHN, NAST & GRAF, P.C.
DIANNE M. NAST
1101 Market Street
2400 One Reading Center
Philadelphia, PA 19107
Telephone: 215/238-1700

LOWEY DANNENBERG BEMPORAD
& SELINGER, P.C.
RICHARD B. DANNENBERG
747 Third Avenue
New York, NY 10017
Telephone: 212/759-1504

LAW OFFICE OF BERNARD M. GROSS, P.C.
DEBORAH R. GROSS
1500 Walnut Street
Sixth Floor
Philadelphia, PA 19102
Telephone: 215/561-3600

SACHNOFF & WEAVER, LTD.
LOWELL B. SACHNOFF
30 South Wacker Drive
Suite 2900
Chicago, IL 60606
Telephone: 312/207-1000

WOLF POPPER ROSS WOLF & JONES
LAURENCE D. PASKOWITZ
845 Third Avenue
New York, NY 10022
Telephone: 212/759-4600

LAW OFFICE OF ANDREW J. OGILVIE
ANDREW J. OGILVIE
300 Montgomery Street
Suite 700
San Francisco, CA 94104
Telephone: 415/981-1122

Counsel for Respondents

MOTION FILED
JUL 15 1994

No. 93-1993

(4)

In The

Supreme Court of the United States

October Term, 1994

IN RE WELLS FARGO SECURITIES LITIGATION

WELLS FARGO & CO., *et al.*,

Petitioners,

v.

HOWARD GREENWALD, *et al.*,

Respondents.

On Petition For Writ of Certiorari
To The United States Court of Appeals
For The Ninth Circuit

MOTION FOR LEAVE TO FILE BRIEF
and
BRIEF AMICI CURIAE OF THE AMERICAN ELECTRONICS ASSOCIATION
and
THE ASSOCIATION OF PUBLICLY TRADED COMPANIES IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI

JONATHAN C. DICKEY
THOMAS M. PETERSON
KEVIN P. MUCK*
BROBECK, PHLEGER & HARRISON
One Market, Spear Street Tower
San Francisco, CA 94105
(415) 442-0900

Attorneys for Amici Curiae The American Electronics Association and The Association of Publicly Traded Companies

**Counsel of Record*

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

26 pp

No. 93-1993

In The

Supreme Court of the United States

October Term, 1994

IN RE WELLS FARGO SECURITIES LITIGATION

WELLS FARGO & CO., *et al.*,

Petitioners,

v.

HOWARD GREENWALD, *et al.*,

Respondents.

On Petition For Writ of Certiorari
To The United States Court of Appeals
For The Ninth Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICI CURIAE

Pursuant to Rule 37.2, the American Electronics Association ("AEA") and the Association of Publicly Traded Companies ("APTC") move the Court for leave to file the attached brief, as *amici curiae*, in support of the petition of Wells Fargo & Co. and others for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit. Counsel for petitioners has consented to the filing of the brief. Counsel for respondents has refused to give consent.

The AEA represents some 3,000 companies in 44 states, spanning the breadth of the electronics industry, including the semiconductor, software, computer, telecommunications, networks and systems fields.

APTC consists of over 500 corporations. APTC's membership includes the newest and smallest publicly traded companies, as well as larger, more mature corporations. Since its founding in the 1970's, APTC has represented thousands of companies before the federal government and regulatory agencies. As the name implies, APTC represents companies in every industry and concentrates on issues of concern common to every public company, rather than those which affect a certain region, economic sector, or industry. APTC strives to: (1) enhance fair and efficient access to the capital markets; (2) increase the opportunity to maximize investment return to long-term investors; and (3) preserve the ability to manage corporate affairs responsibly, free from unnecessary governmental regulation and frivolous litigation.

The members of the AEA and the APTC, like other similarly situated corporations, face the prospect of securities class action litigation virtually any time there is a significant decline in the price of their stock. *Amici* submit that the decision of the court of appeals in this case will exacerbate the trend by preventing district courts from subjecting allegations of securities fraud to meaningful scrutiny. Many members of the AEA and the APTC are located within the jurisdiction of the Ninth Circuit and thus stand to be particularly affected by the decision below.

Although this motion is "not favored" under Rule 37.2, it is presented in the belief that the brief *amici curiae* may assist the Court in its Rule 10 consideration of whether *certiorari* should be granted.

1. Since the petition was filed, the Second Circuit has expressly declined to follow the decision of the Ninth Circuit in this case, announcing that "the dissent by Judge Trott in *Wells Fargo* [is] more consonant with case law in this Circuit." *Shields v. Citytrust Bancorp. Inc.*, ___ F.3d ___, 1994 U.S.App. LEXIS 13465 (2d Cir. June 2, 1994). Thus, one office of the *amici curiae* brief is to discuss *Shields* and the widened, patent circuit conflict that has developed since the petition was filed.

2. The Ninth Circuit's decision minimizes the requirements for pleading a securities fraud case. This minimalist view of pleading strictures is antithetical to Rule 9(b) of the Federal Rules of Civil Procedure and to well-informed viewpoints expressed in Congress and by those Executive Branch officers charged with responsibility for the development and enforcement of the nation's securities laws. The Ninth Circuit has made it easier to charge securities fraud at a time when informed sentiment favors greater protection to defendants by discouraging unjustified charges of fraud and dampening the increasingly automatic filing of securities fraud litigation whenever stock prices decline. Thus, another office of the *amici curiae* brief is to show that the Ninth Circuit's liberal hospitality toward general allegations of fraud is at cross-purposes with other developments in the nation's securities laws.

CONCLUSION

This motion should be granted.

Dated: July 14, 1994

Respectfully submitted,

JONATHAN C. DICKEY
THOMAS M. PETERSON
KEVIN P. MUCK*
BROBECK, PHLEGER & HARRISON
One Market, Spear Street Tower
San Francisco, CA 94105
(415) 442-0900

Attorneys for Amici Curiae The American Electronics Association and The Association of Publicly Traded Companies

*Counsel of Record

No. 93-1993

In The

Supreme Court of the United States

October Term, 1994

IN RE WELLS FARGO SECURITIES LITIGATION

WELLS FARGO & CO., *et al.*,

Petitioners,

v.

HOWARD GREENWALD, *et al.*,

Respondents.

On Petition For Writ of Certiorari
To The United States Court of Appeals
For The Ninth Circuit

BRIEF AMICI CURIAE OF THE AMERICAN ELECTRONICS ASSOCIATION and THE ASSOCIATION OF PUBLICLY TRADED COMPANIES IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI

TABLE OF CONTENTS

Page

BRIEF AMICI CURIAE 1

DESCRIPTION AND INTEREST OF AMICI CURIAE 2

SUMMARY OF ARGUMENT..... 3

ARGUMENT 4

I. *Certiorari* Should Be Granted to Resolve a Conflict Among the Circuits Concerning the Application of F.R.Civ.P. Rule 9(b) to the *Scienter* Requirement for Implied Rights of Action Under Section 10 of the Securities and Exchange Act (15 U.S.C. § 78j(b))..... 4

II. *Certiorari* Should Be Granted Because the Decision of the Ninth Circuit is at Cross-Purposes with a General Trend Favoring More Protection Against Unmeritorious Securities Fraud Allegations, Not Less..... 6

A. There Is a Need for Effective Devices to Curb Unmeritorious Securities Fraud Allegations..... 6

B. The Current Debate on Securities Reform and "Safe Harbor" Provisions Underscores the Importance of Heightened Scrutiny of Securities Fraud Suits..... 9

CONCLUSION 16

INDEX OF AUTHORITIES

Pages

CASES

Greenstone v. Cambex Corp., 975 F.2d 22 (1st Cir. 1992) 6

In re GlenFed, Inc. Securities Litigation, 12 F.3d 893 (9th Cir. 1993), *reh'g en banc granted*, 1994 U.S. App. LEXIS 3331 (9th Cir. Feb. 25, 1994) 5

In re Time Warner, Inc. Securities Litigation, 9 F.3d 259 (2d Cir. 1993) 6

Shields v. Citytrust Bancorp. Inc., ___ F.3d ___, 1994 U.S.App. LEXIS 13465 (2d. Cir. June 2, 1994) 3, 4, 5, 6, 12

STATUTES & RULES

F.R.Civ.P. Rule 9(b) ..... *passim*

F.R.Civ.P. Rule 10 3

F.R.Civ.P. Rule 37.2 ..... 1, 3

Securities and Exchange Act (15 U.S.C. § 78j(b)) 4

OTHER AUTHORITIES

Beese, Jr., J. Carter, "Investor Protection Through Better Disclosure," Keynote Address at the Association of Publicly Traded Companies, 1994 Government Relations Conference, Washington, DC (June 6, 1994) 14

Bowers and Gupta, "Shareholder Suits Beset More Small Companies," *Wall St. J.*, March 9, 1994 11

INDEX OF AUTHORITIES – Continued

Pages

Dunbar, Frederick, and Juneja, Vinita, "Recent Trends II: What Explains Settlements in Shareholder Class Actions?" (NERA 1993) 7, 11

Grundfest, J., *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 Stanford Law Review 961 (1994) 15

Harlan, Christi, "SEC Seeks to Beef Up Safe Harbor Provisions," *Wall St. J.*, May 17, 1994 14

Lerach, William S., Testimony Before the Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs (June 17, 1993) 10, 11

Levitt, Arthur, "Private Litigation Under the Federal Securities Laws," Remarks at the Securities Regulation Institute, University of California, San Diego, Coronado, California (January 26, 1994) 7, 8

O'Brien, Vincent, and Hodges, Richard, "A Study of Class Action Securities Fraud Cases, 1988-1993," (Law & Economic Consulting Group Inc., 1993) 7

Proceedings and Debates of the 103rd Congress, Second Session, 140 Cong.Rec., S3685-01, S3706-S3707, 1994 WL 95349 (Cong.Rec.) (March 24, 1994) 8

Schmitt, Richard B., "More Companies Succeed in Defending Charges That They Defrauded Investors," *Wall St. J.*, April 30, 1992 10

INDEX OF AUTHORITIES – Continued

Pages

Venture One for National Venture Capital Association and American Entrepreneurs for Economic Growth, *The Impact of Securities Fraud Suits On Entrepreneurial Companies* (January 1994) 8

No. 93-1993

In The

Supreme Court of the United States

October Term, 1994

IN RE WELLS FARGO SECURITIES LITIGATION

WELLS FARGO & CO., *et al.*,

Petitioners,

v.

HOWARD GREENWALD, *et al.*,

Respondents.

On Petition For Writ of Certiorari
To The United States Court of Appeals
For The Ninth Circuit

BRIEF AMICI CURIAE OF THE AMERICAN ELECTRONICS ASSOCIATION and THE ASSOCIATION OF PUBLICLY TRADED COMPANIES

This brief *amici curiae*, accompanied by motion for leave to file under Rule 37.2, is presented by the American Electronics Association ("AEA") and the Association of Publicly Traded Companies ("APTC") in support of the petition of Wells Fargo & Co. and others for a writ of *certiorari* to review the decision of the United States Court of Appeals for the Ninth Circuit in this cause, reported below at 12 F.3d 922.

DESCRIPTION AND INTEREST OF AMICI CURIAE

The AEA represents some 3,000 companies in 44 states, spanning the breadth of the electronics industry, including the semiconductor, software, computer, telecommunications, networks and systems fields.

APTC's membership includes more than 500 corporations, ranging from the newest and smallest publicly traded companies, to more mature corporations of medium size, to some corporations of Fortune 500 dimension. Since it was founded in the 1970's, APTC has represented the interests of its members before branches of the federal government. As the name implies, APTC represents companies in every industry and concentrates on issues of concern common to every public company, rather than those which affect a certain region, economic sector, or industry. APTC strives to: (1) enhance fair and efficient access to the capital markets; (2) increase the opportunity to maximize investment return to long-term investors; and (3) preserve the ability to manage corporate affairs responsibly, free from unnecessary governmental regulation and frivolous litigation.

The members of the AEA and the APTC, like other similarly situated corporations, face greater prospects of securities class action litigation if the Ninth Circuit decision remains in effect. Indeed, many members of the AEA and the APTC are located within the geographic region covered by the Ninth Circuit.

SUMMARY OF ARGUMENT

The decision of the Ninth Circuit in this case is manifestly in conflict with the decisions of other circuits and the conflict has widened since the petition was filed. The Second Circuit has now expressly declined to follow the Ninth Circuit's decision because it represents a departure from the heightened pleading standard required in securities fraud actions under F.R.Civ.P. Rule 9(b). *Shields v. Citytrust Bancorp, Inc.*, ___ F.3d ___, 1994 U.S. App. LEXIS 13465 (2d Cir. June 2, 1994).

The Ninth Circuit's decision diminishes the role of pleading rigor as a tool to curb unmeritorious securities fraud allegations at a time when an informed consensus is moving in favor of greater protection for defendants. Congress and the SEC perceive intolerable costs imposed on publicly-traded companies by excessive numbers of securities fraud cases, blithely filed on a near automatic basis in response to any stock market misfortune. If such suits are not subject to effective, early merit screening, they impose undesirable *in terrorem* effects, including litigation costs and coerced settlement payments. Rigorous pleading requirements for fraud and safe harbor protections for forward looking statements made by securities issuers are devices that impose merit screening. These rules of law balance shareholder rights of redress against the need to deter unmeritorious "strike" litigation. The Ninth Circuit multiplies the costs of unmeritorious litigation and begets more of the same when it relaxes fraud pleading standards and makes forward looking statements broadly actionable.

ARGUMENT

I. *Certiorari* Should Be Granted to Resolve a Conflict Among the Circuits Concerning the Application of F.R.Civ.P. Rule 9(b) to the *Scienter* Requirement for Implied Rights of Action Under Section 10 of the Securities and Exchange Act (15 U.S.C. § 78j(b))

The conflict among circuits ably described by petitioners is now blatant. In *Shields v. Citytrust Bancorp, Inc.*, ___ F.3d ___, 1994 U.S. App. LEXIS 13465 (2d Cir. June 2, 1994), the Second Circuit expressly declined to adopt the reasoning of the Ninth Circuit in *Wells Fargo*, preferring Judge Trott's dissent as a correct statement of the law.

In *Shields*, plaintiff's "pleading technique" was described by the court as "coupl[ing] a factual statement with a conclusory allegation of fraudulent intent." 1994 U.S. App. LEXIS 13465 at *15. The court found that these allegations did not contain facts which "would indicate conscious fraudulent behavior or recklessness," or alternatively would "demonstrate both motive and opportunity to commit fraud." *Id.* at *16. Among other things, the court rejected plaintiff's contention that "motive and opportunity" could be inferred from the allegation that defendants artificially inflated the price of Citytrust stock "to protect their executive positions and the compensation and prestige they enjoy thereby" (*id.* at *18-19). The Second Circuit held that establishing an inference of motive requires a plaintiff to do "more than merely charge that executives aim to prolong the benefits of the position they hold," and explained the consequences of a rule to the contrary:

> If motive could be pleaded by alleging the defendant's desire for continued employment, and opportunity by alleging the defendant's authority to speak for the company, the required showing of motive and opportunity would be no realistic check on aspersions of fraud, and mere misguided optimism would become actionable under the securities laws.

Id. at 20.

The Second Circuit declined to follow what plaintiff characterized as "the less demanding view of the pleading requirements in securities fraud cases" enunciated by the Ninth Circuit in *Wells Fargo*. 1994 U.S. App. LEXIS 13465 at *24-25. After noting that the *Wells Fargo* majority opinion did not address the specificity requirements of Rule 9(b), and that "there is some tension" between *Wells Fargo* and *In re GlenFed, Inc. Securities Litigation*, 12 F.3d 893 (9th Cir. 1993), *reh'g en banc granted*, 1994 U.S. App. LEXIS 3331 (9th Cir. Feb. 25, 1994), the Second Circuit concluded:

> In our view, the opinion in *GlenFed* and the dissent by Judge Trott in *Wells Fargo* are more consonant with case law in this Circuit.

Shields, 1994 U.S. App. LEXIS at *26.

Shields is therefore instructive on three counts: (1) it illustrates the divergent approaches adopted by various courts regarding the requirements for pleading scienter; (2) it confirms that the issues presented by the petition are not merely academic, but rather ones with significant repercussions; and (3) it rejects the proposition that averments about job security similar to those asserted by the

plaintiffs in the *Wells Fargo* case are sufficient to allege scienter.

For the reasons explained by the Second Circuit, the heightened pleading standard of Rule 9(b) serves the vital function of providing a "realistic check on aspersions of fraud. . . . " *Shields*, 1994 U.S. App. LEXIS 13465 at *20. By contrast, allowing plaintiffs to proceed with extraordinarily costly class action litigation without offering anything more than conclusory (and often illogical) averments of "motive" and "opportunity" will increase the flood of lawsuits alleging "fraud by hindsight," and create additional "opportunities for 'undeserved settlements.' " *Id.* at *20-21, citing *In re Time Warner, Inc. Securities Litigation*, 9 F.3d 259, 263-64 (2d Cir. 1993).[1]

II. *Certiorari* Should Be Granted Because the Decision of the Ninth Circuit is at Cross-Purposes with a General Trend Favoring More Protection Against Unmeritorious Securities Fraud Allegations, Not Less

A. There Is a Need for Effective Devices to Curb Unmeritorious Securities Fraud Allegations

Arthur Levitt, Chairman of the SEC, has publicly commented on the problems posed by automatic allegations of securities fraud filed when the price of traded stock falls. "The proponents of litigation reform deserve

---

[1] *See also Greenstone v. Cambex Corp.*, 975 F.2d 22, 25 (1st Cir. 1992), in which Chief Judge Breyer noted that allowing plaintiffs to circumvent Rule 9(b) in pleading scienter would sanction "fraud by hindsight."

to be taken seriously, however, because there are indications that our current system is flawed." He further stated that "the Commission also recognizes that the current system imposes substantial costs on issuers."[2]

There is a strong empirical basis for these observations. One study indicates that over the last five years, more securities fraud cases have been brought in California federal courts than any other state in the country.[3] Another study indicates that technology companies are sued far more frequently than any other industry, pay the highest average settlements of any industry – over $9 million – and pay the highest percentages of settlement dollars in relation to investors' market losses.[4] Even so, the average settlement recovery in the cases studied was less than 7% of investor losses.[5] Still another study of several hundred public companies reveals that on average, companies which have been sued for securities fraud spent almost $700,000 on legal fees, and had their premiums almost double for Director & Officer insurance.

---

[2] Chairman Arthur Levitt, "Private Litigation Under the Federal Securities Laws," Remarks at the Securities Regulation Institute, University of California, San Diego, Coronado, California (January 26, 1994 at pp. 3-4).

[3] *See* Vincent O'Brien and Richard Hodges, "A Study of Class Action Securities Fraud Cases, 1988-1993," (Law & Economic Consulting Group Inc., 1993), at pp. 1-10 (hereinafter "O'Brien and Hodges").

[4] Frederick Dunbar and Vinita Juneja, "Recent Trends II: What Explains Settlements in Shareholder Class Actions?" (NERA 1993), Tables 5, 6, and 7 (hereinafter "Dunbar and Juneja").

[5] *Id.*, Tables 6 and 7.

The great majority of companies also reported being more reluctant to publicly discuss company performance as a result of being sued.[6]

Chairman Levitt has concluded, "a litigation system imposes tremendous unnecessary costs when it is abused by investors or their attorneys. Our challenge is to find ways to minimize its costs while preserving the rights of defrauded investors."[7]

Others studying the situation have reached the Chairman's view. Senator Domenici concluded after months of investigation that "these frivolous lawsuits are such a menace to publicly traded companies on the NASDAQ that the NASDAQ Self Regulatory Organization decided to recommend reforms to Senator Dodd and me."[8]

---

[6] Survey conducted by Venture One for National Venture Capital Association and American Entrepreneurs for Economic Growth, *The Impact of Securities Fraud Suits On Entrepreneurial Companies* (January 1994).

[7] A. Levitt, *Private Litigation*, pp. 1-2.

[8] Statement of Senator Domenici on Introduction of the Private Securities Litigation Reform Act, S. 1976, March 24, 1994. "Proceedings and Debates of the 103rd Congress, Second Session," 140 Cong.Rec., S3685-01, S3706-S3707, 1994 WL 95349 (Cong.Rec.), at 156-64 (March 24, 1994).

Underscoring Senator Domenici's remark, a recent study of 500 companies sued for securities fraud between 1988 and 1993 showed that 38% were NASDAQ traded companies. California was the headquarters for nearly a third of the companies in the study. *See* O'Brien and Hodges.

B. The Current Debate on Securities Reform and "Safe Harbor" Provisions Underscores the Importance of Heightened Scrutiny of Securities Fraud Suits

The need to strike a reasonable accommodation between the legitimate rights of investors to seek redress for fraud and the deterrence of meritless strike suits has been recognized within Congress and the SEC. While Congress considers the possibility of legislative reforms, the SEC is contemplating changes to the "safe harbor" rules governing certain forward-looking statements made by issuers.[9] The Ninth Circuit's decision, which would inhibit meaningful analysis of securities actions at the pleading stage, affects these important issues and therefore merits consideration by this Court.

1. F.R.Civ.P. Rule 9(b) requires specificity in the pleading of fraud allegations. Apart from the court of appeals' decision here, where the whole concept of specificity seems to have been abandoned outright, the debate has been over whether the pleading rigor required under Rule 9(b) should be increased.

On March 24, 1994, in response to the problems noted by Chairman Levitt and others, Senators Dodd and Domenici introduced Senate Bill 1976. The Bill was the product of extensive testimony and fact-gathering in 1993 and

---

[9] Petitioners define a "forward-looking statement" as "any statement used by a corporation or its management regarding future developments. For example, disclosures of financial forecasts, predictions or economic trends, and management's plan for future operations are types of forward-looking statements." *See* Pet., p. 5, n.6.

1994 from a wide range of industry experts, academicians, economists, public company executives, and shareholder advocates. The testimony before the Subcommittee on Securities of the Senate Banking Committee focused particular attention on whether existing statutes, rules and regulations, including the Federal Rules of Civil Procedure, provided sufficient safeguards against frivolous securities litigation. Mr. William Lerach, a leading member of the plaintiffs' securities bar,[10] testified that *no* reforms were needed, and that "there are ample legal safeguards in place to protect against unwarranted actions." He expressly cited Rule 9(b) as one of those safeguards: "Federal Rule of Civil Procedure 9(b) requires that securities fraud claims be pleaded with particularity and that each defendant's role in the illegal fraud be set forth in detail."[11] To buttress his argument that Rule 9(b) is working, and that more securities fraud lawsuits are being dismissed on the pleadings, he relied on a 1992 *Wall Street Journal* article describing a purported trend of more frequent dismissals of securities suits. Ironically, one of the principal cases discussed in the *Wall Street Journal* article was the trial court's decision in this case.[12] Later, the *Journal* was reporting an opposite trend,

---

[10] Mr. Lerach is one of the counsel for Respondents in this case.

[11] William S. Lerach, Testimony Before the Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs (June 17, 1993), at p. 5.

[12] Richard B. Schmitt, "More Companies Succeed in Defending Charges That They Defrauded Investors," *Wall St. J.*, April 30, 1992, at B1-2.

namely, that *more* frivolous suits are being brought, particularly against smaller companies.[13]

Consistent with his argument that Rule 9(b) is working, Mr. Lerach urged reform of a different kind, namely, that Congress adopt a "mandatory rule" that plaintiffs in securities class actions can obtain discovery from a defendant corporation whenever a stock price decline is preceded by insider selling.[14] The reason given for this suggested reform is informative. Mr. Lerach argued that this "modified pleading requirement" is required because "in most jurisdictions, a plaintiff cannot survive a motion to dismiss even if he or she shows that such trading took place immediately before such a stock drop."[15]

---

[13] B. Bowers and V. Gupta, "Shareholder Suits Beset More Small Companies," *Wall St. J.*, March 9, 1994, at B5.

[14] William S. Lerach, Testimony, June 17, 1993, *supra*, at 26-27.

[15] *Id.* at 26-27. Other advocates who testified or submitted statements to Congress similarly have argued that Rule 9(b) is an adequate safeguard, and that legislative reform is not needed. For example, Professor Joel Seligman of the University of Michigan Law School responded to criticisms about the ineffectiveness of Rule 9(b) by arguing in conclusory fashion that Rule 9(b) was effectively used to dismiss complaints in approximately 60% of some 46 motions studied. Professor Seligman offered no data, however, indicating either that any of the dismissals in question were without leave to amend, or that there was any uniformity, geographic or otherwise, to the cases studied. In the vast majority of cases, particularly in the Ninth Circuit, motions to dismiss are either denied, or, if granted, are granted with leave to amend. According to a 1993 study of some 280 cases over a two year period, only *five* cases in the Ninth Circuit were dismissed without leave to amend. *See* Dunbar and Juneja, *supra*.

Congress has moved to expand Rule 9(b) to require pleading of scienter with particularity. Senators Dodd and Domenici include in Senate Bill 1976 a provision to add a new section to the 1934 Act. New section 39(a) would provide:

> INTENT – In an implied private action arising under this title in which the plaintiff may recover money damages from a defendant only on proof that the defendant acted with some level of intent, the plaintiff's complaint shall allege specific facts demonstrating the state of mind of each defendant at the time the alleged violation occurred.

Although it cannot be predicted whether Congress will enact reform legislation, or what form that legislation will ultimately take, the discussion reveals the idiosyncratic nature of the *Wells Fargo* opinion. The Ninth Circuit has lowered the required pleading specificity just as debate has focused on whether *more* specificity should be mandated.

2. This case demonstrates the fate-tempting hazards facing a company which makes forward-looking statements. If months after they are made, such statements turn out to be inaccurate, the threat of a class action lawsuit looms large, even if the statements were entirely reasonable at the time they were made. As the Second Circuit noted in *Shields*, unless allegations of fraud are subject to meaningful scrutiny, "mere misguided optimism would become actionable under the securities laws." 1994 U.S. App. LEXIS 13465 at *20.

Senate Bill 1976 contains a provision which would direct the SEC to consider the need for rulemaking or

legislation to strengthen the Commission's so-called "safe harbor" rules, and to provide trial courts with appropriate procedural devices for dismissing securities suits based on forward-looking statements otherwise protected by such "safe harbor" rules. Senate Bill 1976, Section 201, reads as follows:

> SEC. 201. SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS.
>
> (a) CONSIDERATION OF REGULATORY OR LEGISLATIVE CHANGES – In consultation with investors and issuers of securities, the Securities and Exchange Commission shall consider adopting or amending its rules and regulations, or making legislative recommendations, concerning-
>
> (1) criteria that the commission finds appropriate for the protection of investors by which forward-looking statements concerning the future economic performance of an issuer of securities registered under section 12 of the Securities Exchange Act of 1934 will be deemed not to be in violation of section 10(b) of that Act; and
>
> (2) procedures by which courts shall timely dismiss claims against such issuers of securities based on such forward-looking statements if such statements are in accordance with any criteria under paragraph (1).
>
> (b) COMMISSION CONSIDERATIONS – In developing rules or legislative recommendations in accordance with subsection (a), the Commission shall consider-
>
> (1) appropriate limits to liability for forward-looking statements;

(2) procedures for making a summary determination of the applicability of any Commission rule for forward-looking statements early in a judicial proceeding to limit protracted litigation and expansive discovery;

(3) incorporating and reflecting the scienter requirements applicable to implied private actions under section 10(b); and

(4) providing clear guidance to issuers of securities and the judiciary.

Fast upon the heels of this proposed legislation, the SEC announced that it would begin actively reviewing its safe harbor rules and considering rule-making to strengthen the existing safe harbors for forward-looking statements.[16] SEC representatives have publicly commented on the need for reform in this area.[17] Similarly, several commentators recently have expressed the view that greater protections should be extended to companies making forward looking statements – even to the point of "implying" a private right of action for such statements, and amending Rule 10b-5 to require a showing of "knowing" securities fraud sufficient to demonstrate "actual

---

[16] Christi Harlan, "SEC Seeks to Beef Up Safe Harbor Provisions," *Wall St. J.*, May 17, 1994, at C1, C18.

[17] SEC Commissioner Carter Beese publicly complained that the safe harbor rules are not working, and that procedural rules modeled after the business judgment rule should be promulgated by the SEC in order to encourage more forward-looking disclosures, and to grant public companies "the freedom to be wrong." *See* J. Carter Beese, Jr., "Investor Protection Through Better Disclosure," Keynote Address at the Association of Publicly Traded Companies, 1994 Government Relations Conference, Washington, DC (June 6, 1994), at p. 4.

knowledge that the projection is false" as a precondition to bringing suit.[18]

Once again, the Ninth Circuit's opinion is diametrically positioned. The court of appeals held that dismissal was improper because the complaint adequately alleged misrepresentations in Wells Fargo's Annual Report regarding management's "belief" that loan loss reserves were "adequate." 12 F.3d at 930. Thus, allowing the *Wells Fargo* suit to go forward strikes at the heart of the concerns motivating Congress and the SEC, namely, the ability of plaintiffs to predicate a securities fraud suit based on statements of this kind.

3. It cannot be disputed that there is a strong public policy of deterring litigants from bringing frivolous cases which (a) tie up federal court dockets, (b) force defendants to spend millions of dollars on legal fees (or an equivalent amount to settle the case), (c) result in little or no benefit to investors on whose behalf these cases ostensibly are brought, and (d) cause public companies to provide less forward-looking information to the financial markets. If the court of appeals' decision is an aberration, then the public policy interest has necessarily been pinched by the inappropriately broad allowance of securities fraud damage suits.

Rigorously and uniformly enforced, existing Rule 9(b) represents a powerful deterrent against abusive shareholder class action suits. Indeed, the failure of the

---

[18] J. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 Stanford Law Review 961, 1011-1015 (1994).

lower courts consistently to impose stringent pleading standards under Rule 9(b), as exemplified by the court of appeals' decision in this case, has sparked the call for legislative reform. While the proposals embodied in Senate Bill 1976 confirm the seriousness of the problem, it has traditionally been the province of this Court to promulgate and enforce uniform Rules of Civil Procedure. Granting the petition would provide the Court with the opportunity to discharge its oversight function regarding threshold pleading requirements in the federal courts.

CONCLUSION

Filing a class action lawsuit has almost become a Pavlovian response to a declining stock price. The court of appeals' decision inhibits the power of federal courts to curtail this disturbing and undesirable phenomenon. Accordingly, *amici* respectfully ask the Court to grant *certiorari* and reverse the decision of the Ninth Circuit.

Dated: July 14, 1994

Respectfully submitted,

JONATHAN C. DICKEY
THOMAS M. PETERSON
KEVIN P. MUCK*
BROBECK, PHLEGER & HARRISON
One Market, Spear Street Tower
San Francisco, CA 94105
(415) 442-0900

Attorneys for Amici Curiae The American Electronics Association and The Association of Publicly Traded Companies

*Counsel of Record

MOTION FILED
JUL 15 1994

(5)

No. 93-1993

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

IN RE WELLS FARGO SECURITIES LITIGATION

WELLS FARGO & CO., ET AL.,

Petitioners,

v.

HOWARD GREENWALD, ET AL.,

Respondents.

On Petition for Writ of Certiorari To The United States Court of Appeals For the Ninth Circuit

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF OF THE AMICUS CURIAE AMERICAN BANKERS ASSOCIATION IN SUPPORT OF THE PETITIONERS

JOHN J. GILL III
Counsel of Record
MICHAEL F. CROTTY
THOMAS J. GRECO
AMERICAN BANKERS ASSOCIATION
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 663-5026

Attorneys for Amicus Curiae

July 15, 1994

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. 1-800-347-8208

1994

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1994

No. 93-1993

IN RE WELLS FARGO SECURITIES LITIGATION

WELLS FARGO & CO., ET AL.,

Petitioners,

v.

HOWARD GREENWALD, ET AL.,

Respondents.

On Petition for Writ of Certiorari
To the United States Court of Appeals
For the Ninth Circuit

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE OF THE AMERICAN BANKERS ASSOCIATION IN SUPPORT OF PETITIONERS

In accordance with Rule 37.2 of the Supreme Court Rules, the American Bankers Association respectfully moves for leave to file a brief as amicus curiae in support of the Petitioners. The Petitioners have consented to this filing, and their written consent is filed with this brief. Counsel for the Respondents have declined to consent.

The American Bankers Association is the principal national trade association of the commercial banking industry in the United States. As a representative of the industry, the Association has a distinct interest in ensuring that our members are not subject to the burden and expense encountered when defending against unfounded claims of securities fraud.

The decision of the Ninth Circuit in the case below establishes a pleading standard in securities fraud cases which will simply encourage the continued filing of such debilitating lawsuits. By failing to adhere to the standards of pleading fraud under the Federal Rules, the holding below will allow the resources of both the banking industry and the judiciary to be squandered.

Consequently, the Ninth Circuit's decision raises issues of great importance to banking, and we respectfully suggest that the Court might benefit from a brief that discusses those issues from a perspective broader than that of the immediate parties to the case.

WHEREFORE, the American Bankers Association moves that leave be granted to file the attached brief as amicus curiae.

Respectfuliy submitted,

JOHN J. GILL III
General Counsel
Counsel of Record

MICHAEL F. CROTTY
Deputy General Counsel
for Litigation

\s\

THOMAS J. GRECO
Associate General Counsel

AMERICAN BANKERS ASSOCIATION
1120 Connecticut Avenue, NW
Washington, D.C. 20036
(202) 663-5026
Attorneys for Amicus Curiae

July 15, 1994

QUESTION PRESENTED

Did the Ninth Circuit err in concluding, contrary to well-reasoned decisions from other circuits, that a complaint:

a. satisfies the "misrepresentation" element of a Rule 10b-5 claim by alleging that a bank's extraordinary increase in its loan loss reserve for one period implied that the reserve for a previous period was fraudulently understated?

b. satisfies the "scienter" element of a Rule 10b-5 claim by alleging that corporate defendants were motivated to perpetrate a fraud solely to maximize their compensation and job security?

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

TABLE OF AUTHORITIES iii

INTEREST OF THE AMICI CURIAE 1

REASONS FOR GRANTING THE WRIT 3

1. THE PLEADING STANDARDS FOR SECURITIES FRAUD ADOPTED BY THE NINTH CIRCUIT ARE INSUFFICIENT FOR CLAIMS BASED ON INADEQUATE LOAN LOSS RESERVES AND CONFLICT WITH DECISIONS IN OTHER CIRCUITS 3

A. Loan Loss Reserves 3

B. Conflicts in the Circuits 5

CONCLUSION 10

TABLE OF AUTHORITIES

Page

CASES:

Billard v. Rockwell International Corp., 683 F.2d 51 (2d Cir. 1985) 7

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) 8,9

DiLeo v. Ernst & Young, 901 F.2d 624 (7th Cir. 1990) 7

Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990) 8

Romani v. Shearson Lehman Hutton, 929 F.2d 875 (1st Cir. 1991) 7

Semegen v. Weidner, 780 F.2d 727 (9th Cir. 1985) . . . 9

In Re Wells Fargo Securities Litigation, 12 F.3d 922 (9th Cir. 1993) 3

Wool v. Tandem Computers Inc., 818 F.2d 1433 (9th Cir. 1987) 7

RULES:

Fed. R. Civ. P. 9(b) 7, 8

Page

MISCELLANEOUS:

American Institute of Certified Public Accountants - Banking Committee, *Audits of Banks* (2d ed. 1983) 5

William C. Baskin III, *Using Rule 9(b) to Reduce Nuisance Securities Litigation*, 99 Yale L.J. 1591 (1990) 7

Brent Bowers and Udayan Gupta, *Shareholder Suits Beset More Small Companies*, Wall St. J., March 9, 1994 9

Financial Accounting Standards Board, *Accounting Standards - Current Text - General Standards* . . 5

Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 6 - Elements of Financial Statements (1985) 4

Golembe Associates, *The Adequacy of Bad Debt Reserves for Banks - A Preliminary Study* (1972) 4

Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 Harv. L. Rev. 961 (1994) 9

T. Hardy, *The Allowance for Loan Losses: Fact or Fiction?* (June, 1986) 4, 5

Page

Office of the Comptroller of the Currrency, *Comptroller's Handbook for National Bank Examiners* (1984) 5

Robert Morris Associates, *Managing The Allowance for Loan and Lease Losses State of the Art* (1988) 6

Sands, *Lending Practices Land Banks in Court*, Washington Times, April 20, 1990 2

David Siegel and Bill Atkinson, *Now the Worry is that Reserves Are Too High*, Am. Banker, July 13, 1993 6

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1994

No. 93-1993

IN RE WELLS FARGO SECURITIES LITIGATION

WELLS FARGO & CO., ET AL.,

Petitioners,

v.

HOWARD GREENWALD, ET AL.,

Respondents.

On Petition for Writ of Certiorari
To the United States Court of Appeals
For The Ninth Circuit

BRIEF OF THE AMICUS CURIAE AMERICAN BANKERS ASSOCIATION IN SUPPORT OF THE PETITIONERS

INTEREST OF THE AMICI CURIAE

The American Bankers Association ("ABA") files this brief as amicus curiae in support of the Petitioners. The ABA is the principal national trade association of the commercial banking industry in the United States. It has members in each of the fifty states and the District of

Columbia and represents banks of all types (national and state chartered banks) and sizes (money center, regional and community banks). ABA members hold approximately ninety percent of all domestic assets in commercial banks located in the United States.

The matter decided by the court below involves the pleading sufficiency of a complaint of securities fraud under Securities and Exchange Commission Rule 10b-5. This is a legal issue of the utmost concern not only to the banking industry, but to business in general. Of particular interest to the ABA and its members is the treatment of the accounting practice known as reserving against loan losses.

As this Court is no doubt aware, the late 1980's and early 1990's was a time when certain segments of the United States economy suffered through a lingering recession, particularly with respect to real estate. As lenders determine that it is unlikely loans will be repaid and that the declining value of collateral will make the lender undersecured, loan loss reserves are increased. When reserves are increased suddenly and substantially, it is as if the bank spent or lost that money at the time the reserves are set aside. That has an effect upon the net income of the bank and, ultimately, upon the market value of bank stock. It is easy, with benefit of hindsight, to claim that "adequate" loan loss reserves should have been established earlier so as to present a more "accurate" picture of the true value of a bank's stock. In fact, during the most recent economic downturn, numerous shareholder suits were filed against banks containing allegations of securities fraud because of losses in the banks' loan portfolio. *See*, Sands, *Lending Practices Land Banks in Court*, Washington Times, April 20, 1990, at C1.

Because of the expense of such lawsuits and because it is impossible to run a bank if honest and reasonable business judgments are made into guarantees of positive investment results, it is extremely important that courts be able to dismiss suits which fail to state clearly the "fraudulent" activity being charged.

REASONS FOR GRANTING THE WRIT

It is critical for the Court to review the decision of the Ninth Circuit for several reasons. First, as noted in the bank's brief, the holding below conflicts with decisions by other United States Courts of Appeal which have considered the issue. Second, if the Ninth Circuit's decision stands, unmeritorious suits will continue to be filed with the inevitable waste of both judicial and private sector resources.

I. THE PLEADING STANDARDS FOR SECURITIES FRAUD ADOPTED BY THE NINTH CIRCUIT ARE INSUFFICIENT FOR CLAIMS BASED ON INADEQUATE LOAN LOSS RESERVES AND CONFLICT WITH DECISIONS IN OTHER CIRCUITS.

A. Loan Loss Reserves

One of the key holdings by the court below was that the Respondents' complaint adequately states a cause of action under the Securities Exchange Act of 1934. Among the Respondents' allegations is that Wells Fargo deliberately understated its loan loss reserves and, therefore, committed securities fraud. *In re Wells Fargo Securities Litigation*, 12 F.3d 922, 925 (9th Cir. 1993). This presents an important question on which this Court should provide guidance: What is the standard for pleading securities fraud in the context of a claim of inadequate loan loss reserves?

The allowance for loan losses appears on a balance sheet as a deduction from the value of a loan portfolio. Commentators have recognized several functions which could be served by the reserve. These include an experience function, catastrophe function, and a valuation function. Golembe Associates, *The Adequacy of Bad Debt Reserves for Banks - A Preliminary Study* at 2 (1972). *See, also,* Financial Accounting Standards Board (FASB), *Statement of Financial Accounting Concepts No. 6 - Elements of Financial Statements* at 9134 (1985) (hereinafter CON No. 6). The experience function assumes that the loan loss reserve is intended to absorb losses which can be expected to occur in a single average year and is achieved by averaging out actual loss experience from past years. It is viewed as producing "the lowest benchmark" for the loss reserve. T. Hardy, *The Allowance for Loan Losses: Fact or Fiction?* at 8 (June, 1986) (unpublished thesis available at the American Bankers Association library).

In contrast to the experience function, a loan loss reserve based on the catastrophe function assumes that the allowance should enable the lender to withstand loan losses which would occur under unforeseen economic crises such as a depression. *Id.* This probably represents the upper limit on the amount of the reserve but would "artificially inflate the allowance amount and make it difficult for the public as well as bank management to evaluate the problems inherent in a loan portfolio." *Id.* at 9.

Somewhere between these two extremes is the notion of the loan loss reserve serving a valuation function. For example, CON No. 6, ¶ 34, states that some accounts on a balance sheet serve as valuation accounts (i.e., a separate item which reduces or increases the carrying amount of an asset). In this context the loan loss reserve would "represent

a measure of all losses expected in a given loan portfolio through its liquidation in the ordinary course of business." T. Hardy, *supra*, at 10.

The guidance from the accounting profession makes it clear that the loan loss reserve is to serve a valuation function for financial reporting purposes. "The amount of [the loss reserve] can be considered reasonable when the allowance for loan losses . . . is considered by management to be adequate to cover estimated losses inherent in the loan portfolio." American Institute of Certified Public Accountants - Banking Committee, *Audits of Banks* at 61 (2d. ed. 1983).

As to <u>when</u> such losses need to be identified, the accounting standards recognize the factors involved in this undertaking. Paragraph 8 of FASB Statement No. 5: *Accounting for Contingencies* (FASB No. 5), for example, requires that the loss be probable and reasonably estimable before it is accrued. *See*, Financial Accounting Standards Board, *Accounting Standards - Current Text - General Standards* at § C59.105. ("Losses from uncollectible receivables [*e.g.*, principal and interest on loans] shall be accrued when both conditions [probable and reasonably estimable] are met.") The banking regulatory guidance is similar. "[I]t is not the examiner's responsibility to initially ascertain the amount of allowance, but rather to determine that management has exercised its responsibility to use *reasonable* judgment based upon reliable information to arrive at an appropriate allowance." Office of the Comptroller of the Currency, *Comptroller's Handbook for National Bank Examiners* § 217.1 (1984) (emphasis added).

B. Conflicts in the Circuits

As noted in the bank's Petition for Writ of Certiorari, this issue is one which has confronted a number of United States Courts of Appeal, and these courts continue to struggle in their attempts to hold plaintiffs' complaints to the strictures of the Federal Rules of Civil Procedure. What is readily evident from the discussion above is the subjective process for arriving at the "correct" amount of loan loss reserves. Unlike such objective entries on a financial statement as inventory and sales, the amount stated for loss reserves is nothing more than an educated prediction of future events. Robert Morris Associates, *Managing the Allowance for Loan and Lease Losses State of the Art* at 11 (1988). This prediction will likely be based on a system which sets forth a particular method of evaluation (*e.g.*, frequency of review, documentation, minimum allowable allowance, identification of problem loans, allocation of loss for specific loans, etc.) but the decision ultimately remains a guess. *Id.* at 55-60.

As events play themselves out, the correctness of the loan loss reserve calculation can easily be evaluated. From today's standpoint, for example, it has become evident that some financial institutions failed to anticipate the difficulty which would be suffered by certain regions and within certain industries. But miscalculations of the loss reserve, even by a significant amount, do not necessarily represent fraudulent acts by the lending institution. With the improvement in the economy and bank profitability, the pendulum is now beginning to swing. Banks have been criticized for maintaining reserves at *too high* a level and thus *understating* earnings. David Siegel and Bill Atkinson, *Now the Worry is that Reserves Are Too High*, Am. Banker, July 13, 1993, p. 1 col. 1. It is not facetious to suggest that

banks may soon be facing equally groundless fraud claims for over-reserving.

Securities fraud litigation imposes a terrible burden upon both businesses and the judiciary. Shareholder suits, such as the one at issue in this case, typically make broad allegations of fraud based on the inadequacy of loss reserves and are primarily based on 20-20 hindsight. The argument made in such suits is that the bank's financial disclosures state loan loss reserves which later prove to be "inadequate" and, therefore, constitute fraud under section 10(b) of the Securities Act of 1934.

Because of the expense of this type of litigation, it is extremely important for courts to hold plaintiffs to the requirement of Fed. R. Civ. P. 9(b) that fraud allegations be made with "particularity." *Billard v. Rockwell International Corp.*, 683 F.2d 51 (2d Cir. 1985) (Rule 9(b) will be strictly construed to minimize strike suits). *See, also*, William C. Baskin III, *Using Rule 9(b) to Reduce Nuisance Securities Litigation*, 99 Yale L.J. 1591, 1594 (1990)(Use of the pleading standard of Rule 9(b) can reduce the "economic incentives facing a professional plaintiff's attorney . . . for the initiation of [§ 10(b)] actions.") In this case, for example, it is not an overwhelming burden to require the plaintiffs to identify specifically in what respect the loan loss reserves were false or misleading at the time the estimates were made. "[M]ere conclusory allegations of fraud are insufficient, statements of the time, place and *nature* of the alleged fraudulent activities are sufficient." *Wool v. Tandem Computers Inc.*, 818 F.2d 1433, 1439 (9th Cir. 1987) (emphasis added). *See, DiLeo v, Ernst & Young*, 901 F.2d 624, 627 (7th Cir.1990) (plaintiffs' complaint that bank's failure to increase reserves constituted fraud inadequate under Fed. R. Civ. P. 9(b) because circumstances of the

fraud "the who, what, when, where and how" not specified). As the First Circuit noted in *Romani v. Shearson Lehman Hutton*, 929 F.2d 875 (1st Cir. 1991), "We have been especially rigorous in demanding such factual support in the securities context to minimize the chance 'that a plaintiff with a largely groundless claim will bring a suit and conduct extensive discovery in the hopes of obtaining an increased settlement....'" *Id.* at 878.

Concerns over potential misuse of liberal pleading standards under the Federal Rules are particularly acute in class action litigation challenging a bank's loan loss reserve. As the Court has recognized, class action securities litigation of all types "presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975). That danger is certainly present in litigation over a bank's alleged understatement of the loan loss reserve. By definition, every financial institution's provision for loan loss reserves changes over time. Since change is the rule, not the exception, plaintiffs invariably allege that, for some time before the reserve increase, defendants knew or should have known that then-existing reserves were inadequate. *Cf. Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 1621 (1991). If broadbrush allegations such as these suffice to state a claim under Rule 9(b), defendants will have little protection from the burden and expense of litigation.

II. IMPORTANCE OF THE ISSUE

To be sure, the phenomenon described is not isolated to the banking industry. Commentators have recognized that private enforcement of the federal securities laws is "big business" with private class action counsel filing "hundreds

of lawsuits alleging federal securities law violations" and plaintiffs' counsel reaping "hundreds of millions of dollars a year. . . ." Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 Harv. L. Rev. 961, 971-72 (1994) (noting that during the fiscal year ending June 30, 1992, 642 securities and commodities fraud suits were pending in the federal district courts, *see*, n.28).

Every year, many institutions settle unmeritorious claims to avoid the cost and risk of defense. *See* Brent Bowers, Udayan Gupta, *Shareholder Suits Beset More Small Companies*, Wall St. J., March 9, 1994, at B1 (reporting that class action cash settlements to shareholders nearly quintupled to $1.55 billion between 1988 and 1992). Caution in allowing plaintiffs to proceed with securities claims is necessary because

> even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment.

Blue Chip Stamps, 421 U.S. at 740. *Accord Semegen v. Weidner*, 780 F.2d 727, 731 (9th Cir. 1985).

The failure to impose a strict pleading standard in this case sends the wrong signal to the plaintiff bar and

encourages the continued filing of unfounded securities fraud claims.

CONCLUSION

The amicus asks this Court to grant the petition and overturn the decision of the court below. The ruling does not enforce the correct standards for pleading securities fraud. As a result, plaintiffs are encouraged to pursue often groundless allegations and engage in discovery "fishing expeditions." If this Court fails to overturn the Ninth Circuit's ruling, banks and other commercial enterprises are certain to face unfounded charges of fraud every time economic reversals beyond the control of even the most prudent banker cause investors to lose money.

Respectfully submitted,

JOHN J. GILL III
General Counsel
Counsel of Record

MICHAEL F. CROTTY
Deputy General Counsel
for Litigation

THOMAS J. GRECO
Associate General Counsel

AMERICAN BANKERS ASSOCIATION
1120 Connecticut Avenue, NW
Washington, D.C. 20036
(202) 663-5026
Attorneys for Amicus Curiae

July 15, 1994

(6)

Supreme Court, U.S.
FILED
JUL 26 1994
OFFICE OF THE CLERK

No. 93-1993

In The

Supreme Court of the United States

October Term, 1994

IN RE WELLS FARGO SECURITIES LITIGATION

WELLS FARGO & CO., et al.,

Petitioners,

vs.

HOWARD GREENWALD, et al.,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

OPPOSITION TO MOTIONS FOR LEAVE TO FILE BRIEFS AMICI CURIAE

WILLIAM S. LERACH
(*Counsel of Record*)
JAN M. ADLER
ERIC A. ISAACSON
WILLIAM S. DATO
MILBERG WEISS BERSHAD HYNES & LERACH
600 West Broadway,
Suite 1800
San Diego, CA 92101
Telephone: 619/231-1058

ELIZABETH JOAN CABRASER
JAMES M. FINBERG
WILLIAM M. AUDET
LIEFF, CABRASER & HEIMANN
Embarcadero Center West
275 Battery Street
30th Floor
San Francisco, CA 94111
Telephone: 415/956-1000

Counsel for Respondent

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

8 pp

No. 93-1993

In The

Supreme Court of the United States

October Term, 1994

IN RE WELLS FARGO SECURITIES LITIGATION

WELLS FARGO & CO., et al.,

Petitioners,

vs.

HOWARD GREENWALD, et al.,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

OPPOSITION TO MOTIONS FOR LEAVE TO FILE BRIEFS AMICI CURIAE

Respondents oppose the request of the American Bankers Association ("Bankers Association") and the joint request of the American Electronics Association ("AEA") and the Association of Publicly Traded Companies ("APTC") to file briefs as *amici curiae* in this case. Under Supreme Court Rule 37.1, the filing of an *amicus* brief is "not favored" unless the brief "brings *relevant* matter to the attention of the Court *that has not already been brought to its attention by the parties* . . . . " (Emphasis added.)

The proposed Bankers Association submission purports to discuss the legal issues in the case "from a perspective broader than that of the immediate parties to the case." Bankers Association Motion for Leave to File Brief at 2. It is difficult to see why the interests of the banking industry, which the Bankers Association seeks to foster, would not be adequately represented by the principal defendant in this action, a bank. What seems intuitively obvious is borne out by the Bankers Association's proposed brief, which merely rehashes the same arguments already raised by petitioner Wells Fargo. For that reason, the motion by the Bankers Association should be denied.

The proposed AEA/APTC submission is even more objectionable. It does not even attempt to limit itself to a discussion of the legal issues in the case. Rather, it consists largely of arguments currently being advanced by those political interests lobbying Congress to amend the Securities Exchange Act of 1934. Such blatantly partisan advocacy has its place in the legislative arena; it does not belong in a brief before this Court on a case involving the application of pleading standards found in the Federal Rules of Civil Procedure. To the extent the proposed brief contains any relevant material, it has already been submitted to this Court by the parties.

In an attempt to provide some legitimacy for the AEA/APTC brief, would-be *amici* begin with a citation to the recent decision in *Shields v. Citytrust Bancorp, Inc.*, No. 93-7738, 1994 U.S. App. LEXIS 13465 (2d Cir. June 2, 1994). AEA/APTC Proposed Brief Amici Curiae (hereafter "Proposed Brief") at 4. Although alerting the Court to a relevant case not cited by the parties would be an appropriate role for *amici*, *Shields* was already cited and

discussed in Respondents' Brief in Opposition (at 11-12 n.8). Indeed, the precise language of the Second Circuit's conclusion relied on in the Proposed Brief (at 5) was also quoted by respondents. Petitioners will have the opportunity to file a reply brief in which they can discuss *Shields*. Accordingly, the brief discussion of the *Shields* decision in the AEA/APTC submission is simply unnecessary to this Court's proper consideration of this case.

Having begun with a facially proper but ultimately unnecessary point, the bulk of the AEA/APTC brief degenerates into a political diatribe against securities class actions generally. Emphasizing statements marshalled by proponents of recent efforts to amend the federal securities laws, without reference to the overwhelming amount of contrary evidence,[1] the proposed

---

[1] The movement toward greater protection for defendants is neither a "consensus" nor "informed." Proposed Brief at 3. For instance, the AEA/APTC brief asserts "the need to deter unmeritorious 'strike' litigation." *Id.* Even according to conservative scholars, however, "[m]ost observers agree that strike suit litigation is relatively uncommon." Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. Chi. L. Rev. 1, 78 (1991). The brief also argues that securities fraud cases are "blithely filed on a near automatic basis in response to any stock market misfortune" (Proposed Brief at 3) and characterizes the class action lawsuit as an "almost . . . Pavlovian response to a declining stock price." Proposed Brief at 16. No empirical support is cited for these assertions and, indeed, the available hard data clearly refutes them. In a study submitted to the National Economic Council, the number of one-day stock price drops of 10 percent or greater was calculated and compared with the number of public companies sued in securities fraud class action lawsuits. For the last four years (1989-1992), there were 17,091 such price drops. During that same

amici seek to aggrandize the importance of this case by dragging the Court into a political debate. As the citations in the AEA/APTC brief make clear, that debate belongs in Congress and not this Court. The presentation of this case, which involves the application of an undisputed legal standard to the facts alleged in a particular pleading, does not benefit from the addition of such irrelevant and obviously partisan arguments.

Because the proposed submissions failed to add any substance to the issues before this Court, respondents request that both motions for leave to file *amicus* briefs be denied.

---

period of time, only 484 public companies were sued in securities class action lawsuits, a rate of 2.8 percent. National Association of Securities & Commercial Law Attorneys, Incidence and Economic Impact of Securities Class Action Lawsuits 22 (1994). Finally, proposed *amici* complain loudly about the "excessive numbers of securities fraud cases" (Proposed Brief at 3), at the same time as the enforcement chief of the SEC is stating that "the 'litigation explosion' in securities cases, as described by defendants, doesn't exist." Edward Felsenthal, *SEC On "Explosion" of Suits*, Wall St. J., June 18, 1993, at B4. The AEA/APTC brief fails to point out that over the past 20 years, figures from the Administrative Office of the United States Courts show a slight *decrease* in the number of securities class actions filed. This is particularly significant in light of the fact that over the same time period, every indicator of stock market activity showed exponential growth. *See, e.g.*, Search of Common Stock Database, Securities Data Company, New York, NY (initial public offerings – 9000% increase; common stock offerings – 1200% increase); NYSE and NASDAQ Fact Books (1985-1994) (NYSE share volume – 1800% increase; NASDAQ share volume – 5500% increase).

The purpose of these examples is not to debate the merits of statutory securities law reform. The point is simply that the AEA/APTC brief presents only one side of a very political story which is irrelevant to the narrow legal issue currently before the Court.

Dated: July 26, 1994

Respectfully submitted,

MILBERG WEISS BERSHAD
HYNES & LERACH
WILLIAM S. LERACH
(*Counsel of Record*)
JAN M. ADLER
ERIC A. ISAACSON
WILLIAM S. DATO
600 West Broadway, Suite 1800
San Diego, CA 92101
Telephone: 619/231-1058

LIEFF, CABRASER & HEIMANN
ELIZABETH JOAN CABRASER
JAMES M. FINBERG
WILLIAM M. AUDET
Embarcadero Center West
275 Battery Street, 30th Floor
San Francisco, CA 94111
Telephone: 415/956-1000

BERGER & MONTAGUE, P.C.
SHERRIE R. SAVETT
1622 Locust Street
Philadelphia, PA 19103
Telephone: 215/875-3000

BERMAN, DEVALERIO & PEASE
GLEN DEVALERIO
One Liberty Square
Boston, MA 02109
Telephone: 617/542-8300

CHIMICLES, JACOBSEN & TIKELLIS
PATRICK J. GRANNAN
633 West Fifth Street
Suite 2200
Los Angeles, CA 90071-2010
Telephone: 213/623-8100

GREENFIELD & RIFKIN
RICHARD D. GREENFIELD
MARK C. RIFKIN
344 West Lancaster Avenue
Suite 1000
P. O. Box 259
Haverford, PA 19041-0259
Telephone: 215/649-3900

KAPLAN, KILSHEIMER & FOX
ROBERT N. KAPLAN
685 Third Avenue, 26th Floor
New York, NY 10017
Telephone: 212/687-1980

KOHN, NAST & GRAF, P.C.
DIANNE M. NAST
1101 Market Street
2400 One Reading Center
Philadelphia, PA 19107
Telephone: 215/238-1700

LOWEY DANNENBERG BEMPORAD
& SELINGER, P.C.
RICHARD B. DANNENBERG
747 Third Avenue
New York, NY 10017
Telephone: 212/759-1504

LAW OFFICE OF BERNARD M.
GROSS, P.C.
DEBORAH R. GROSS
1500 Walnut Street
Sixth Floor
Philadelphia, PA 19102
Telephone: 215/561-3600

SACHNOFF & WEAVER, LTD.
LOWELL B. SACHNOFF
30 South Wacker Drive
Suite 2900
Chicago, IL 60606
Telephone: 312/207-1000

WOLF POPPER ROSS WOLF & JONES
LAURENCE D. PASKOWITZ
845 Third Avenue
New York, NY 10022
Telephone: 212/759-4600

LAW OFFICE OF ANDREW J. OGILVIE
ANDREW J. OGILVIE
300 Montgomery Street
Suite 700
San Francisco, CA 94104
Telephone: 415/981-1122

Attorneys for Respondents

No. 93-1993

(7)

Supreme Court, U.S.
FILED
AUG 5 1994
OFFICE OF THE CLERK

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1993

IN RE WELLS FARGO SECURITIES LITIGATION

WELLS FARGO & CO., *et al.*,
Petitioners,
v.
HOWARD GREENWALD, *et al.*,
Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

MELVIN R. GOLDMAN*
JACK W. LONDEN
PAUL FLUM
CAROLYN A. JOHNSTON
MORRISON & FOERSTER
345 California Street
San Francisco, CA 94104
(415) 677-7000

Attorneys for Petitioners

**Counsel of Record*

13 pp

PARTIES TO THE PROCEEDINGS

The parties to the proceedings are listed on page ii of the Petition.

TABLE OF CONTENTS

Page

I. THE NINTH CIRCUIT'S OPINION CREATES AN INTER-CIRCUIT CONFLICT OVER THE REQUIREMENTS FOR PLEADING SCIENTER 2

II. THE NINTH CIRCUIT'S OPINION CREATES AN INTER-CIRCUIT CONFLICT OVER THE REQUIREMENTS FOR PLEADING A MISREPRESENTATION 5

III. RESPONDENTS' PROCEDURAL OBJECTIONS TO THE PETITION ARE MERITLESS 6

TABLE OF AUTHORITIES

Page(s)

Cases

Arazie v. Mullane,
2 F.3d 1456 (7th Cir. 1993) 4

Denny v. Barber,
576 F.2d 465 (2d Cir. 1978) 7

DiLeo v. Ernst & Young,
901 F.2d 624 (7th Cir.),
cert. denied, 498 U.S. 941 (1990) 2, 4

Greenstone v. Cambex Corp.,
975 F.2d 22 (1st Cir. 1992) 4 n.2

In re GlenFed, Inc. Securities Litigation,
11 F.3d 843 (1993), *reh'g en banc granted*, No. 92-55419, 1994 U.S. App. LEXIS 3331 (9th Cir. Feb. 25, 1994) 7

In re Time Warner Inc. Securities Litigation,
9 F.3d 259 (2d Cir. 1993),
cert. denied, 114 S. Ct. 1397 (1994) 6

Kowal v. MCI Communications Corp.,
16 F.3d 1271 (D.C. Cir. 1994) 6

Moore v. Kayport Package Express, Inc.,
885 F.2d 531 (9th Cir. 1989) 7 n.7

Serabian v. Amoskeag Bank Shares, Inc.,
[1993-1994 Transfer Binder]
Fed. Sec. L. Rep. (CCH) ¶ 98,228
(1st Cir. May 27, 1994) ..... 5–6 & n.3

Shapiro v. UJB Financial Corp.,
964 F.2d 272 (3d Cir.),
cert. denied, 113 S. Ct. 365 (1992) ..... 7 & n.6

Shields v. Citytrust Bancorp, Inc.,
[1993-1994 Transfer Binder]
Fed. Sec. L. Rep. (CCH) ¶ 98,239
(2d Cir. June 2, 1994) 2, 3, 4

Tuchman v. DSC Communications Corp.,
14 F.3d 1061 (5th Cir. 1994) 2, 4

Virginia Bankshares, Inc. v. Sandberg,
111 S. Ct. 2749 (1991) 6 n.4

Rules and Regulations

Fed. R. Civ. P.
Rule 9(b) 6, 7
Rule 12(b)(6) 7, 8

Securities and Exchange Commission Rule 10b-5,
17 C.F.R. § 240.10b-5 5

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

No. 93-1993

IN RE WELLS FARGO SECURITIES LITIGATION

WELLS FARGO & CO., *et al.*,
Petitioners,

v.

HOWARD GREENWALD, *et al.*,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The Ninth Circuit's opinion in this case sets forth a pleading standard for securities fraud complaints that is radically different from the standard used by other circuits. Respondents do not seriously dispute the existence of this inter-circuit conflict, but seek to trivialize it. However, the inter-circuit conflict presented by this case is not, as respondents would characterize it, "nonexistent or minimal." The conflict is of serious and immediate concern to litigants in the Ninth Circuit and elsewhere.

I. THE NINTH CIRCUIT'S OPINION CREATES AN INTER-CIRCUIT CONFLICT OVER THE REQUIREMENTS FOR PLEADING SCIENTER.

Respondents' baseball analogy demonstrates that securities fraud plaintiffs are playing by one set of rules in the Ninth Circuit, and a different set of rules in other circuits. A complaint alleging that corporate officers were motivated to defraud corporate shareholders by their desire to keep their jobs and earn more money is a ball at Wrigley Field, Shea Stadium and the Astrodome, and is now a strike at Candlestick Park.

The Second Circuit recently joined the Fifth and Seventh Circuits in explicitly rejecting the Ninth Circuit's holding in this case. In *Shields v. Citytrust Bancorp, Inc.*, [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,239 (2d Cir. June 2, 1994), plaintiff claimed that Citytrust overstated its earnings by understating its loan loss reserves. The Second Circuit affirmed dismissal of the complaint on the ground that the allegations did not raise an inference of scienter. The Second Circuit rejected plaintiff's claim that a motive to defraud could be inferred from defendants' desire to "protect their executive positions and the compensation and prestige they enjoy thereby." *Id.* at 99,655. The Second Circuit concluded:

> To allege a motive sufficient to support the inference that optimistic but erroneous statements were fraudulently made, a plaintiff must do more than merely charge that executives aim to prolong the benefits of the positions they hold. . . . If motive could be pleaded by alleging the defendant's desire for continued employment, and opportunity by alleging the defendant's authority to speak for the company, the required showing of motive and opportunity would be no realistic check on aspersions of fraud, and mere misguided optimism would become actionable under the securities laws.

Id. See also Tuchman v. DSC Communications Corp., 14 F.3d 1061, 1067-69 (5th Cir. 1994); *DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir.), *cert. denied*, 498 U.S. 941 (1990).

The Second Circuit in *Shields* noted that plaintiff, represented by some of the same attorneys representing respondents in this case, urged the Second Circuit to adopt the "less demanding view of the pleading requirements in securities fraud cases" articulated by the Ninth Circuit in this case. The Second Circuit "decline[d] the invitation," concluding that the *Wells Fargo* decision was not "consonant with case law in this Circuit." [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,239, at 99,656.

Shields also rejected the two allegations respondents now proffer in a vain attempt to bolster the scienter element of their 10b-5 claim. First, respondents refer to the allegation in their complaint that on June 10, 1991, "the Company dismissed the claim that Wells Fargo might face a possible increase in non-performing real estate loans for the second quarter of 1991. Rather, the Company noted that for the past 16 years, Wells Fargo averaged only 0.13 of a percentage point in real estate lending losses." (a-55). Respondents also refer to defendants' failure to explain the stock price drop on June 24. Respondents contend that the juxtaposition of these public statements with the announcement of the increased loan loss reserve on June 25 supports an inference of scienter. Importantly, the Ninth Circuit *did not rely on either allegation* in holding that the complaint satisfied the scienter requirement. But even if the Ninth Circuit had held these allegations sufficient to support an inference of scienter, that holding would conflict with *Shields* and other out-of-circuit authorities.[1]

The Second Circuit rejected similar allegations in *Shields*. Plaintiff there alleged that defendants announced that Citytrust was expecting 1989 to be its twelfth consecutive year of record earnings just two months before it announced that it would report a loss for 1989 as a result of an increase in its loan loss reserve. The Second Circuit concluded: "This technique is sufficient to allege that the defendants

---

1. In addition, respondents' contention makes no sense as a factual matter. The complaint contains no facts suggesting that either statement was false, much less made with the requisite scienter. Nowhere do plaintiffs allege that nonperforming real estate loans in the second quarter exceeded the bank's past experience, nor do plaintiffs allege how or why these statements support the inference that the loan loss reserve three months earlier was fraudulently understated.

were wrong; but misguided optimism is not a cause of action, and does not support an inference of fraud." [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,239, at 99,654. The Seventh Circuit agreed in *Arazie v. Mullane*, 2 F.3d 1456, 1467-68 (7th Cir. 1993), concluding that "temporal proximity between positive statements stressing a firm's strengths and announcements of poor economic performance do not create an inference that the earlier statements were fraudulent." *See also Tuchman*, 14 F.3d at 1069.[2]

Second, respondents contend that their allegation that defendants were motivated to inflate Wells Fargo's stock price in order to "squeeze" short sellers of the stock supports an inference of scienter. Once again, the Ninth Circuit does not even mention this allegation in its opinion, much less rely on it. And if the Ninth Circuit had relied on this allegation, it would have been in conflict with *Shields*, as well as other out-of-circuit decisions rejecting claims of "motive" unless a concrete economic benefit can be or has been gained by the fraud. *See, e.g., Shields*, [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,239, at 99,655; *see also Tuchman*, 14 F.3d at 1068-69; *DiLeo*, 901 F.2d at 629.

It is of course true that when a stock price goes up instead of down, short sellers lose money. However, the complaint does not allege, and it defies logic to assume, that any defendant would benefit from "squeezing" short sellers of Wells Fargo stock. At best, the allegation invites the speculative inference that defendants engaged in securities fraud simply out of spite. "People sometimes act irrationally, but indulging ready inferences of irrationality would too easily allow the inference that ordinary business reverses are fraud. One who believes that another has behaved irrationally has to make a strong case." *DiLeo*, 901 F.2d at 629.

---

2. Respondents' reliance on *Greenstone v. Cambex Corp.*, 975 F.2d 22, 26 (1st Cir. 1992) is misplaced. In that case, the First Circuit concluded that, under the facts alleged, it was *not* reasonable to infer that defendants "would have had to have known" certain facts before they became public.

II. THE NINTH CIRCUIT'S OPINION CREATES AN INTER-CIRCUIT CONFLICT OVER THE REQUIREMENTS FOR PLEADING A MISREPRESENTATION

The Ninth Circuit's holding that the statements of bank management's belief were actionable is also fundamentally inconsistent with decisions from other circuits. Neither the Ninth Circuit nor respondents' Opposition identifies a single allegation which, if true, would prove that management did not actually believe that the loan loss reserve was "adequate," and that certain HLT loans were "substantially secured." Again, a recent decision from another Court of Appeals highlights the inter-circuit conflict created by the decision below.

In *Serabian v. Amoskeag Bank Shares, Inc.*, [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,228 (1st Cir. May 27, 1994), upon which respondents rely, the First Circuit applied a very different legal standard, examining the complaint to see if it contained particularized facts that were inconsistent with contemporaneous statements of management's belief. The complaint contained specific factual allegations that an outside consulting firm retained by the bank had reported "serious deficiencies" in the loan loss reserve, and that there had been internal reviews and audits concluding that increased reserves were urgently needed. These specific allegations were juxtaposed with the bank's contemporaneous public statements "characterizing its loan review capabilities as 'strong' and its ALL approach as 'conservative'." [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 99,559.

The First Circuit concluded that these facts satisfied the misrepresentation element of Rule 10b-5, and contrasted those specific allegations with the type of allegations the Ninth Circuit found sufficient in this case:

> In this series of allegations, plaintiffs do more than simply identify management problems or point to statements that put a positive spin on the company's circumstances, without indicating how or why defendants should have known the descriptions were inaccurate. Rather, these paragraphs present a con-

> trast between what company officials were hearing internally about their loan review effectiveness and the adequacy of their ALL, and what the company was telling the public *at the same time.*

Id. at 99,560 (emphasis in original).[3]

In *In re Time Warner Inc. Securities Litigation*, 9 F.3d 259, 266 (2d Cir. 1993), *cert. denied*, 114 S. Ct. 1397 (1994), the Second Circuit, applying the same legal standard as the First Circuit in *Serabian*, concluded that the absence of particularized facts inconsistent with management's stated belief was fatal to the 10b-5 claim. *See also Kowal v. MCI Communications Corp.*, 16 F.3d 1271, 1278 (D.C. Cir. 1994). In contrast, in this case the Ninth Circuit held that conclusory allegations, unsupported by any facts, that management did not genuinely believe the statements were true, were sufficient.[4]

III. RESPONDENTS' PROCEDURAL OBJECTIONS TO THE PETITION ARE MERITLESS

Despite these undisputed conflicts between the Ninth Circuit's opinion and decisions from other circuits, respondents seek to evade this Court's review by advancing two inconsistent arguments.

First, respondents argue that the Ninth Circuit's failure explicitly to rely on Rule 9(b) justifies denial of the petition, even though the Ninth Circuit discusses Rule 9(b)'s specificity requirement and pur-

---

3. While *Serabian* does approve certain aspects of the *Wells Fargo* decision, the First Circuit incorrectly assumed that the *Wells Fargo* complaint explained how the named loans were connected to the alleged inadequacy of the bank's loan loss reserve. The First Circuit noted that the *Serabian* complaint referred to specific problem borrowers, but emphasized that "[t]he complaint does not allege a connection, however, between these specific loans and the asserted problems with internal monitoring and inadequate ALL." [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 99,561 n.11. Since the *Wells Fargo* complaint also fails to allege how the nine "bad" loans are connected with the alleged deficiencies in the bank's loan loss reserve, it appears that the First Circuit would have affirmed dismissal in this case.

4. Respondents do not dispute that by so holding the Ninth Circuit misapplied this Court's decision in *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749 (1991).

ports to rely on other 9(b) decisions.[5] For that reason, and because the distinction between Rules 9(b) and 12(b)(6) is largely ignored in practice in securities fraud cases, lower courts are likely to construe *Wells Fargo* as a 9(b) case.

Moreover, the Ninth Circuit's holding conflicts with out-of-circuit decisions holding that similar complaints did *not* satisfy Rule 12(b)(6). For example, in *Shapiro v. UJB Financial Corp.*, 964 F.2d 272 (3d Cir.), *cert. denied*, 113 S. Ct. 365 (1992), the Third Circuit affirmed the district court's dismissal under Rule 12(b)(6) of portions of a complaint claiming a loan loss reserve at a given point in time was inadequate.[6] *See also Denny v. Barber*, 576 F.2d 465 (2d Cir. 1978) (affirming district court's dismissal of complaint for failure to state a claim under Rule 12(b)(6), as well as for failure to meet the requirements of Rule 9(b)).

Second, respondents suggest that it *may* be a waste of the Court's time to review the Ninth Circuit's opinion in this case because the conflict between the Ninth Circuit and other circuits *may* disappear when the Ninth Circuit issues its *en banc* decision in *In re GlenFed, Inc. Securities Litigation*, 11 F.3d 843 (1993), *reh'g en banc granted*, No. 92-55419, 1994 U.S. App. LEXIS 3331 (9th Cir. Feb. 25, 1994). To the contrary, the Ninth Circuit already refused to correct the inter-circuit conflict created by the *Wells Fargo* decision when it denied petitioners' petition for review of this case *en banc*.

Moreover, as respondents concede, the opinion below concludes that the complaint satisfies Rule 12(b)(6), and does not specifically discuss the requirements of Rule 9(b). Since the panel's opinion in *GlenFed* discusses only Rule 9(b), there is no assurance that the *en*

---

5. For example, the Ninth Circuit opinion rejects defendants' argument about the allegation regarding the nine loans, holding that "this level of specificity is not required at the pleading stage." (a-6). In support of that holding, the Ninth Circuit quotes from another Ninth Circuit decision regarding Rule 9(b), *Moore v. Kayport Package Express, Inc.*, 885 F.2d 531, 540 (9th Cir. 1989). (a-6 to a-7).

6. Thus, contrary to respondents' claim, the Third Circuit's decision in *Shapiro* is not "completely consistent" with the Ninth Circuit's decision in this case. Opp. at 7 n.4.

banc decision will reach the Rule 12(b)(6) issues addressed in the *Wells Fargo* opinion. Although petitioners argued in the Petition for Rehearing *en banc* in the Ninth Circuit that the two panels' reliance on different rules did not eliminate the intra-circuit conflict, the Ninth Circuit rejected that argument by denying rehearing in *Wells Fargo*. Thus, the inter-circuit conflict created by the decision below is likely to remain unresolved, absent review by this Court.

Dated: August 4, 1994.

MELVIN R. GOLDMAN*
JACK W. LONDEN
PAUL FLUM
CAROLYN A. JOHNSTON
MORRISON & FOERSTER

Attorneys for Petitioners

* *Counsel of Record*